

The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Published monthly; subscription \$2.00 per annum in advance.
Advertising rates sent on request.

The Editorial Committee will be pleased to receive contributions on subjects of interest. Papers which may not be deemed suitable will be returned, if desired.

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10 Adelaide Street East, Toronto

VOLUME XXXIV, No. 2

FEBRUARY, 1939

ISSUE No. 187

(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

Editorial Comment

About Our Contributors

The number of manuscripts coming to us in recent months is indication of an increasing desire in some of our members and others to write. A flow of literary contributions from a growing and live profession should be a commonplace thing, and this awakening interest is a promising sign; our editorial committee have reason to feel encouraged.

More than once in response to our invitation to contribute to the pages of this journal, members have offered the excuse of "lack of facility in writing." Such plea is no excuse. It is only after one has made a study of a problem and has come to grips with his subject that he is able to write about it. And to write is not easy; the art must be cultivated. In a public interview a few days ago one of our distinguished Canadian poets stressed this by warning young writers against the "snare of facility," and he quoted Richard Sheridan, the noted Irish dramatist of the eighteenth century, who had made the observation in his day that "easy writing makes hard reading."

We recall some years ago complimenting a member of our profession from the Old Country on a luncheon address which was a model of perfection in composition and delivery. Any member of the audience could readily have remarked that here was a "born" speaker. That, however, would have been an entirely wrong conclusion; instead he had been a "born" worker. The speaker afterwards confided to the editor that when he began his professional career he resolved to develop his powers of writing and speaking. At first his discouragements were many; he would spend hours, he said, on the composition of a single sentence and whole evenings on the construction of a small paragraph. Often he would set his task aside for a few days to allow his subconscious mind to reach out for the right word or the exact phrase to express his thoughts. Ease in writing, the choice of words and clearness of expression did not come to him by chance; they were the product of hours of perseverance, patient study and hard work. His achievement should be an incentive to the scores of ambitious young men who have come into the profession within the last ten or fifteen years possessed of a sound practical training and a good academic background.

"Writing maketh an exact man" is even more pertinent for the accountant and the student of today than it was in Bacon's time. While the articles published in THE CANADIAN CHARTERED ACCOUNTANT are for the benefit of the reader, we have more than once reminded the contributors that they themselves have received the greatest benefit through the hours of study and research devoted to the preparation of their manuscript. The exercise of committing one's thoughts to writing is a powerful means of expanding the mind and of developing a logical and systematic arrangement of one's opinions and conclusions. No member of any profession or calling can ever hope to become thoroughly familiar with its principles unless he writes upon, as well as reads, the subjects with which it deals.

History tells us that in the rise of ancient Athens her young men were required to swear: "Thus in all that is wise will we transmit this city, not only not less but greater and more beautiful than it was transmitted to us." It is no wonder that Athens became the intellectual and military capital of the world; it is no surprise that the fame of Greek civilization reaches down to our time. With the

opportunities for study and research open to members today, let each of us honestly ask himself, "What am I contributing to the profession?"

Natural Business Year as Fiscal Year It is not necessary to acquaint accountants with the marked advantages that would come to every corporation from the adoption of a natural business year as its fiscal year. They are already familiar with them. The wonder is that so many alert executives have not grasped the significance of the natural cycle of operations of their businesses and the importance of having their accounting period coincide with it. It may be quite true that, because of lack of appreciation of the place which accounting has assumed in the efficient conduct of a business, members of the legal profession (who are responsible for the incorporation of companies) have indicated the calendar year-end as the end of its fiscal year when possibly a more illogical date could not have been chosen. But this is no excuse for business executives to perpetuate blind errors.

In their daily practice, members of the profession have an opportunity of enlightening their clients on this subject. As we explained to a leading financial paper a few weeks ago, the natural business year is that twelve-month period which reflects as nearly as may be the results of one complete cycle of business activity; the adoption of it as the fiscal period is advocated in the interests of economy and efficiency. When a business chooses a period other than the natural one as its accounting period, it is actually cutting off the closing period of one annual cycle and joining it to the opening period of the succeeding one. An artificial and unnatural combination of business data is thus created from which to draw comparisons and also to determine policies for future activities.

Advantages From Adoption What are some of the advantages to be derived from the adoption of the natural business year as the fiscal year? A company can conduct its annual stocktaking, close its accounts, prepare its financial statements, obtain its annual audit, analyze its past operations and formulate its plans for the future at that time of the

year when its activities are at their lowest ebb. The financial statements will then reflect the results of a complete cycle of operations. The management will be able to determine its administrative policies on a sounder basis, and the auditors render more effective the service of constructive counsel.

According to the December *Bulletin* of the American Institute of Accountants, the research and statistical division of Dun & Bradstreet, Incorporated, has prepared six special bulletins analyzing seasonal fluctuations in particular industries and indicating natural-fiscal closing dates. For shoe manufacturers, November 30th is suggested as a closing date because "production inventories, receivables and liabilities are likely to be at approximately their lowest point for the year both for 'make-up' houses and 'in-stock' houses." For concerns engaged in making home radio sets, March 31st would be most suitable because "sales, inventories and receivables would commonly be at or about their lowest annual levels." For farm equipment manufacturers October 31st is suggested and is already in use by two large national firms in this industry, the reason being that "books closed at that date give a picture of the year's business after the close of the selling season and before costs of production of the next year's models have entered into the expense ledger." The end of January would be the most advantageous date for department stores because after the Christmas rush and the clearance sales of the following weeks inventories are usually at their lowest level for the year and current liabilities are also approximately at their lowest points.

Since efficiency in the administration of industry is of ever pressing importance, we invite our readers to send in any observations or practical suggestions which they may have on the subject of the natural business year.

*Public Debts
of Canada*

At times one hears the suggestion made that, to ease the burden of interest payments on the debt of the Dominion and provincial governments, Canada should take a lesson from Great Britain and Australia and refund at substantially lower rates of interest such of their outstanding bonds as are at present carrying rates far above current levels. One must understand the general circumstances

surrounding the conversion of the debts in those countries to appreciate the full implications in that suggestion.

What are the facts? The reference to Great Britain has to do with the replacement between 1932 and 1934 of a large part of the national debt by bonds bearing much lower rates of interest. It was not a forced conversion, but was effected because the bonds either had matured or had reached the date at which, by the terms of issue, the government was entitled to call them in for redemption. Those circumstances are important.

*Australia's
Courageous
Policy*

The case of Australia is different and has helpful lessons in national co-operation. In a recent address published in *The Financial Times* of Montreal, F. C. Biggar, Secretary of The Canadian Bank of Commerce, sets forth some interesting facts about Australia. Serious developments in the financial affairs of both the Commonwealth and of the States, Mr. Biggar points out, became evident in 1929. Owing to the increasing deficits caused by shrinking revenues and mounting government expenditures a complete economic breakdown was imminent by 1931, and it was imperative that drastic action be taken by the several governments. Local prejudices were set aside and the interests of the federal and state authorities became merged in the desire to prevent a collapse. A conference was called of representatives of the Commonwealth and the States and of a group of economists, which resulted in the adoption of the "Premiers' Plan." Under the plan the holders of all Commonwealth and State bonds, payable in Australia only—a total of £586 millions or approximately 50 per cent. of the total bonded indebtedness—were asked to exchange these issues for new Commonwealth bonds bearing interest at rates which would effect a saving of 22½ per cent. of the total interest charges on the former issues; as partial offset, the 7½ per cent. super income tax would be waived.

The plan went much further than that. The several governments agreed that simultaneously with this conversion of debt they would reduce their controllable expenditure by twenty per cent. The salaries and wages of government staffs, based on the schedules of 1929-30, and war pensions were to be reduced by a similar percentage,

and old age pensions by 12½ per cent. Higher income and sales taxes were to be imposed so as to ensure a balanced annual budget. Besides, an appeal was to be made to industry for similar reductions in salaries, and banks asked to reduce interest on deposits.

This courageous dealing with a very serious situation in Australia had the desired effect. We understand that only seven per cent. of the bondholders (possibly unaware of the conversion) did not reply to the request for an exchange of their holdings; forced conversion was necessary for only three per cent. of the outstanding bonds.

*Centralized
Authority
Essential*

When considering whether or not a similar concerted effort might be made in Canada to put an end to the endless deficits of the Dominion, provincial and municipal governments and of the national railways and to the enormous annual increases in the public debt which unless soon stopped can only lead to national bankruptcy, there are some pertinent facts to be faced. One of prime importance is the urgent need for greater central government control in Canada. Could anything possibly be more absurd than the spectacle of a population of about eleven million people with nine provincial governments duplicating in large measure at an enormous expense the legislative measures, the activities and the administration of our federal government? That is what exists in this country. Our whole concept of what effective government is needs to be examined—examined, moreover, with an open mind by intelligent people in all parts of Canada to determine what can be accomplished through co-operation on the part of those who truly seek the good of this country.

There are two lessons to be learned from what took place in Australia, and we quote from Mr. Biggar's address:

"The first," he states, "is that the sponsors of the Plan emphasized the fact that it must be accepted or rejected as a whole. Any attempt to adopt some of the proposals and discard others would, they said, inevitably defeat the results sought.

"The second is that some years prior to the crisis the various States of the Commonwealth had relinquished to the federal authorities their former right to borrow money by way of direct bond issues. A Loan Council had been formed, consisting of representatives from each State of the Commonwealth and from the Federal Government, to which Council the States were required to submit their annual budgets showing the amount of new borrowings they considered necessary for their requirements.

"If the Council concluded that the proposed borrowings by any State were excessive it had full authority to reduce the sum to be borrowed by such an amount as it saw fit. Issues of Commonwealth bonds were then made to cover federal requirements of that year, plus the sums approved for state expenditure. Concentration of financial control in the hands of the Loan Council was an essential factor in the success achieved by the Premiers' Plan. A proposal for a similar centralized control was made in Canada some three years ago but was unequivocally rejected by most of our provinces."

From 1931 to 1937 the average rate of interest on the bonds of Australia dropped 25 per cent. to 3.93 per cent. According to the budget address of the Minister of Finance in the Canadian House of Commons on 16th June last, the refunding operations of our Federal government during the past three years have effected an annual saving in interest of over \$10 millions. The unmatured funded debt of the Dominion government at 31st March last was \$3,314 millions, of which 74.09 per cent. was payable in Canada. The annual interest on this amounts to the huge sum of \$117 millions. This, it will be noted, is an average rate of 3.53 per cent., which compares favourably with that paid on the Australian debt.*

Staggering Figures

The 1938 edition of the *Canada Year Book* contains a brief summary showing the changes in the national debt of Canada between 1914 and 1937 together with relevant statistical tables. In 1914 there was a net debt of \$336 millions incurred for the most part in the building of railroads and canals and in developing the general productive capacity

*The average interest for all the Canadian provinces is considerably above that of Australia. The public accounts, for instance, of the Province of Manitoba for the fiscal year ended 30th April 1938 show that the direct funded debt of the province at that date amounted to approximately \$94 millions. The interest payable on this indebtedness, calculated directly from the rates shown for each issue, totals slightly less than \$4.5 millions, which is an average rate of approximately 4.7 per cent. The direct funded debt indicated does not include treasury bills and exchequer bonds amounting to \$33.5 millions or the contingent liability on guaranteed securities amounting to \$6.7 millions. The public accounts of the Province of Saskatchewan for the fiscal year ended 30th April 1937 show that the funded debt of the province at that date amounted to approximately \$124 millions bearing total interest charges of somewhat less than \$6 millions. The average rate of interest was approximately 4.8 per cent. This indebtedness does not include treasury bills amounting to more than \$75.7 millions or the contingent liability of the province on guarantees of debentures and seed grain and other advances totalling \$37.3 millions.

of the country. To a large extent, therefore, the debt could be considered as an investment from which the nation would receive some return either directly or indirectly. The debt at the close of the fiscal year on 31st March 1937 was considerably more than three billion dollars, an increase of over 800%. Most of this tremendous increase can be attributed to war expenditures which, of course, brought no productive returns to the country. The excessive burden which this debt imposes on the Canadian people is realized when it is known that about 35% of all tax receipts, or almost 30% of total governmental revenues, is required to pay the annual carrying charges on it. In 1914 the interest payment per capita of population was one dollar and sixty-four cents; in 1937 these charges amounted to twelve dollars and thirty-six cents, based on estimated population figures. Thus the per capita interest burden increased over 650% while population was increasing 41%.

In addition to this direct debt the Dominion is heavily involved in its guarantees of railway securities and other smaller undertakings. At 31st March 1938 there was an indirect obligation on securities held by the public amounting to more than 1,270 million dollars.

*Complacent
Taxpayers*

Three score and twelve years ago the *British North America Act* was framed for a Canada whose areas were separated by vast distances of space and time. That explains why provision was made for provinces with sovereign powers closely paralleling those of the Dominion. The developments of science, undreamed of by the Fathers of Confederation, have changed all that. By radio the word spoken in Halifax or Ottawa or Vancouver today may be heard simultaneously in every city, town and hamlet throughout the land, and through the developments in aeronautics an individual may be transported 3500 miles from the Atlantic to the Pacific in the time ordinarily taken to go a few score miles in the "horse and buggy" days of Confederation.

In a country so over-governed as ours—with the same income of individuals and corporations taxed by several governing bodies towards a similar end, with the recurring annual deficits of all ten governments, and with no promise of relief for the future, what greater emergency than this is needed to bring all parties together to settle upon a re-

distribution of powers between the federal and provincial jurisdictions? Not until the citizens arouse themselves out of their continued yet unrefreshing sleep will the endless duplication of government activities be halted, waste stopped and the protests of the taxpayer respected. "A Despotism may almost be defined as a tired Democracy," states G. K. Chesterton in *Everlasting Man*; "as fatigue falls on a community, the citizens are less inclined for that eternal vigilance which has been truly called the price of Liberty, and they prefer to arm only one single individual to watch the city while they sleep."

**McKesson &
Robbins Case**

Until the results of the investigations into the frauds of the McKesson & Robbins firm in the United States are made public and the facts of the case are known, our Editorial Committee have decided that no useful purpose is served by making any comment thereon.

The situation in the McKesson & Robbins case, however, has created a very considerable interest throughout the country in auditors' reports and has brought forth much useful comment on the subject in the editorial columns of national newspapers and magazines. For the benefit of our readers, the Editorial Committee are taking the opportunity of reproducing in this month's issue some of those comments.

Editor's Note: It is a coincidence that the subject of public debts and overlapping of government functions with which we deal this month is also being stressed by Mr. McCullagh in his radio addresses on government in Canada. We want to state that our comments were prepared before, not after, this series of addresses was begun.

A.H.C.

SOME THOUGHTS ON TAXATION OF MINING COMPANIES

By H. Wyburn George, Chartered Accountant,
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THE question of the taxation of the mining industry, particularly in relation to precious metals, is becoming one of increasing interest to chartered accountants. A good deal has already been written on the subject, some of which, while critical of the present taxation laws, does not attempt to suggest a definite solution.

The purpose of this article, rather than to add to what has already been said on present taxation legislation, is to offer some suggestions towards a more equitable basis of taxation for the mining industry. It is hoped that the submission of some definite proposals will have the effect of stimulating interest in the matter both within the profession and through its members to the industry, thus leading to some action towards the end in view.

The necessity for making special provision for specific industries has already been recognized by various taxation authorities and to adopt the proposals as set out, at least so far as the Dominion and British Columbia taxation acts are concerned, would not appear to require any drastic amendments to these acts. This aspect of the matter will be dealt with at the end of this article.

There are two phases of the subject, one being the lack of uniformity between the Dominion and Provincial tax authorities and the other, the necessity of mining concerns being accorded special treatment in the matter of deductions from gross income.

With regard to the first, it will be readily admitted that uniformity in methods of treatment is highly desirable. To obtain this the industry itself should, with the assistance of our profession and of the legal profession, prepare a brief setting out a basis of taxation which would be acceptable to both taxing authorities as well as to the industry.

The second feature is the vital one, as the equity or otherwise of the taxation depends on the method of treatment of certain items, particularly depletion and depreciation.

Why Special Treatment?

The necessity for special treatment of mining concerns may be questioned by parties having no direct interest therein, but this matter should be viewed from the standpoint of the welfare of the community at large. It cannot be denied that the gold mining industry makes a very valuable contribution towards the welfare of Canada and each Province where mines are located. The study of the grades of ore and costs of operating the gold mines of Canada discloses the fact that in a great many cases the grade is so low and the cost of extraction so high that any material reduction in the price of gold would prevent these mining concerns from operating at a profit. The operation of low grade properties has been made possible only by the venture of private capital. While the industry might appear to be a rich source for taxation, in all fairness, the capital so ventured should be given the fullest consideration, inasmuch as under any circumstances mining is a very hazardous business.

The greatest hazard, and one which under even the present high level of scientific attainment cannot be eliminated, is the lack of certainty of ore contents. No amount of legislation can of course eliminate this risk but proper recognition by the various taxing authorities of the effect of this risk on the venture as a whole could help to offset the bad effects of the physical disability of the industry by a fairer treatment in the matter of allowances as deductions from gross income.

It is not proposed to set out here the various methods at present in use but rather to outline a fair and equitable plan of dealing with those items of a special nature when considered in relation to mining companies, more particularly gold producers. Certain of the suggestions will be found, at least in part, to be already in use by one or other of the taxing authorities.

The capital of a mining company is invested in fixed assets which, unlike those of the ordinary commercial business, cannot be disposed of at anything approaching their cost or even book value in the event of the company ceasing its operations. In some cases the cost of dismantling and transportation of movable assets may be such that complete abandonment may be more economic. Generally speaking

the fixed assets of a mining company can be divided into two classes as follows:

(1) "Immovable" or "depletable assets," are those items whose economic life is only that of the mine itself. In the event of the mine having to cease its operations, they would have to be practically abandoned and become a total loss, except in so far as provision may have been made for this eventuality.

(2) "Movables," as their name implies, are removable. They would be capable of disposal and, subject to the question of dismantling and transportation, would have an economic life more nearly in accord with that of each item itself.

Immovable or Depletable Assets

The principle of making allowance for "depletion" is recognized by most taxing authorities but the items to which they will permit its application are not the same in all cases nor do they allow it in respect to certain items which the writer claims should be included.

The following is a suggested grouping of fixed assets under the first heading, "Immovable or Depletable Assets," to which it is considered fair and equitable that the principle of depletion should be applied.

(1) Mining claims and properties—It is in respect to these that the principle of depletion is primarily applied. The only point arising in this connection is the actual cost for depletion purposes. The plan adopted by the government of British Columbia appears to be fair and reasonable, namely, to allow all actual outlays for acquisition, exploration, pre-production development and reasonable administration expenses up to the time of coming into commercial production.

(2) Pre-production expenses—These have been defined by the Dominion authorities as all items which would be allowed as expenses in arriving at net taxable income of producing companies. It would appear that these would cover the items included by the British Columbia government in arriving at depletable cost as set out in the preceding paragraph. In the past the Dominion authorities have allowed pre-production expenses to be written off on a tonnage basis, the rate being a matter of individual arrangement. It is now proposed by the Dominion govern-

ment to adopt a percentage basis of either fifteen or twenty per cent. except for those companies whose tonnage rate has been fixed.

(3) Current development expense—The attitude of the British Columbia government with respect to this expense would appear to be a reasonable one, as it cannot be fairly claimed that this is part of the cost of production of the period in which the development work is done since it is usually undertaken for the purpose of locating and opening up new ore bodies. The provincial authorities therefore do not, as the Dominion government does, allow development expense as a charge against the fiscal period in which it is incurred, but add it to the depletable value. While it may seem to be more conservative to write off at once what may prove to be an unprofitable expenditure, on the other hand to so do may have the effect of depriving present shareholders of dividends to which they would be entitled were such expense not written off against current profits. It is true that if written off at once an immediate saving in taxes would be effected which would be available for distribution, but this would amount to only the tax rate percentage of the total development expense, whereas if treated as a depletable item a much greater amount would be available. While under the latter method of treatment a greater amount of taxes would be payable in the particular year, the effect would be to spread the allowance over a number of succeeding years, thus giving to the shareholders of the year when the development was done their full share of profits actually earned and to subsequent shareholders the benefit of the extended allowances.

(4) Camp-site, grading (in some cases trackage), waterworks, underground shafting and timbering, etc.—All of these items must of necessity cease to have any value whatsoever when the mine is exhausted; their economic life therefore is that of the mine itself.

(5) Mill, camp and other buildings — These outlays, with the exception of a certain amount of salvage in the way of lumber, fittings, etc. which under some conditions might be obtainable, have no value when operations at the mine cease and will represent a loss which is not likely to be taken care of through depreciation at established rates.

(6) Transportation and cost of installation of movable assets—In the case of the ordinary commercial business

it is the practice, and correctly so, to include these expenditures as part of the cost of the respective items. In the case of a mine, however, such additional cost of individual items, over the invoice cost plus freight to nearest railhead, cannot possibly be recovered in the event of a subsequent sale. It is suggested, therefore, that while such "installed cost" should be ascertained and recorded in the plant and machinery records for insurance and other purposes, the actual cost of transportation from railhead to mine and the cost of installation should, in the financial records, be kept in a separate account and included with "depletable assets."

(7) Loss on assets replaced or abandoned — In the early stages of the development and production of a mine certain equipment may be installed as the most suitable, but later some of this may prove to be unsuitable either in type or size, and replacement is made. Such replacement will usually result in a loss with respect to the items replaced, even after allowing for salvage and depreciation. Tunnels may be driven, necessitating the erection of buildings at or near the tunnel which, when that section has been worked out, have to be torn down or probably abandoned, thus resulting in a loss. Such changes in equipment or buildings should be regarded as fairly chargeable as they are in the nature of development work.

The British Columbia government will allow the loss on assets replaced or abandoned as an expense of the period in which the replacement is made, while the Dominion authorities designating this as a "capital loss," will not allow it as an expense at any time. Neither of these two methods of treatment is desirable, as in the first case such replacement is made, not for the benefit of the fiscal period in which it is made but for the future, and in the second, it might fairly be held that the installation of the original plant was in the nature of an experiment, the future alone to prove its value as suitable and adequate for the purpose. It is therefore claimed that any loss, after deducting depreciation and salvage, in respect to assets replaced or abandoned, should in the case of a mine be transferred from the original asset account to a special account which might be termed "loss on assets abandoned or replaced," and included among the depletable assets.

Depletion Allowances

Having arrived, in a broad way, at a grouping of assets under the heading of "Immovables or depletable assets," the method of determining the charge for depletion is not a difficult matter. The rate for this charge for depletion is obtained as the percentage that the tonnage milled is of the estimated ore reserves. The impossibility of accurately estimating the ore reserves presents a problem, but if the estimates are prepared and certified by a competent mining engineer, who should be a member of one of the recognized professional associations, such estimates should be acceptable both to the company and to the taxing authorities. Exploration and development work from time to time will afford such engineer the means of checking his estimates, which should of course be submitted annually.

Variations in estimates of reserves, additional outlays and tonnage milled will mean different depletion rates each year which may cover a wide range, and some writers hold this makes such a plan impracticable for companies to adopt. The government of British Columbia has already adopted this general method of allowance for depletion but without defining in detail the assets to which the principle shall be applied. In making a claim for depletion it is necessary to submit a schedule of depletable values and to substantiate the depletion rate used. A company could, if it so wished, adopt the same method for its own accounting.

It is true that the range of depletion rates might vary considerably from year to year but, with a fairly uniform grade of ore, the variations in rates would be found to follow the same trend as the profits. In other words, when production is high the depletion rate would normally be high and the charge against profits for depletion would also be high; while when production and profits were low the reverse would be the case. This would seem to be a more equitable method than the present one of adopting a more or less arbitrary fixed rate irrespective of variations in profits.

The Dominion government at present allows as a deduction for depletion the arbitrary amount of one-third of the net profits, excluding however any income from sources other than production. It may on first thought be deemed unwise to suggest any change in this respect in view of

this allowance by the Dominion authorities; on the other hand, a comparison of the actual allowances receivable under the two methods will probably disclose, as the writer has found from experience, that the method suggested would represent a greater allowance than the present one-third of the net profit.

It may also be contended that the proposed method would mean that eventually, when amounts aggregating the total depletable value have been allowed, no further allowance would be made. Except during the declining years of the life of a mine, development work is continually being carried on and the cost thereof being added to the depletable value. This would prolong the period during which allowances would be receivable. It is only fair and reasonable that, when a company has received allowances aggregating one hundred per cent. of the value of its depletable assets, no further allowance should be made. Further, it can hardly be expected that the Dominion authorities will continue to allow this depletion to a company regardless of the value of its depletable assets.

Effect on Dividends

While in the province of British Columbia dividends from provincial companies are exempt from taxation in the hands of shareholders, the Dominion government does not allow such exemption but, in the case of dividends from mining companies, does allow the shareholders to deduct twenty per cent. from the amount of such dividends. This deduction is allowed on the theory that such a dividend in part represents a return of capital. Some people may regard shares in a mining company as an investment, but it must be admitted that to the majority they are a speculation. This means that mining shares are frequently changing hands and the recipient of a dividend may be the owner of the shares for only a short time and may also be a fortunate seller at a profit, so that the dividend to him can in no way be construed as being in part a return of capital.

It is suggested that any allowance for depletion be granted to the company only and conditional on its building up a sinking fund by the investment of a similar amount of cash in trustee securities, thus having the reserve available for distribution at winding up. While this investment of depletion reserves is not presently the established practice

in Canada, it would appear to be the fairest and most equitable method of dealing with the question and its adoption would have the effect of giving the allowance to the persons properly entitled to it, namely, those who are shareholders at the time of winding-up.

The loss of this twenty per cent. exemption would no doubt meet with protest from the speculative shareholder but those who purchase their shares as an investment would be in a better position in a winding-up, if the company had properly invested out of the proceeds of production the amount of its depletion allowances. While mining shares will, of their very nature, continue to represent somewhat of a "gamble" the greater protection afforded the final shareholders under the proposed plan would, it is hoped, have a beneficial effect on the industry as a whole.

Depreciation on Movable Assets

The second group of assets, classed as "Movables," would be subject to a provision for depreciation instead of depletion. There are two points in this connection, one being the question of rate and the other, of the total amounts to be allowed. The present rate of ten per cent. as allowed by the Dominion government, while adequate for a number of mines, will probably prove to be too low for many of the smaller mines which cannot anticipate a productive life of ten years or more. The five per cent. rate as allowed by the province of British Columbia is likely to be sufficient for only a very few of the mines located in that province, the majority not having an estimated productive life of anything approaching twenty years.

The Dominion government will allow an asset to be depreciated up to eighty per cent. of its cost and thereafter only on the remaining twenty per cent. plus additions. The province of British Columbia will allow depreciation only up to seventy-five per cent. of cost and thereafter no further allowance is given except in respect to additions.

It is suggested that the adoption of a standard rate of fifteen per cent. would be more suitable and that depreciation be allowed up to one hundred per cent. of cost. For the prevention of over-allowances for depreciation and also depletion, due to the uncertainty of salvage values, provision could be made in the respective acts that, before final distribution in a winding-up, a mining company should pay tax

on any amount by which its depletion and depreciation reserves exceed the cost of the respective assets after deducting salvage received on disposal.

Possible Amendments

As mentioned at the beginning of this article, to give effect to the suggested basis of allowances to mining companies both the *Income War Tax Act* of the Dominion of Canada and the *Income Tax Act* of British Columbia might require amendments.

The sections of the Dominion Act relating to depreciation and depletion are, section 5, sub-section (a) and section 6, sub-section (b), which also deals with the question of "capital losses." Section 5, sub-section (a) would appear adequate to enable "the Minister" by means of rulings to adopt the suggested basis of allowances to mining companies, with the possible exception—in view of section 6, sub-section (b)—of those relating to what might be termed by some as "capital losses." Sub-section (b) of section 6 does not define what is or shall be considered a "capital loss," and the provisions of the section as it stands may be considered prohibitive. If such is the case, the alternative would be to amend the Act to exclude mining companies from the application of this section or to provide specifically for the desired allowances.

In the case of the provincial Act, the pertinent clauses are contained in section 6, being sub-section (1) clauses (m), (o) and (q) and sub-section (3) clauses (a), (b) and (c). Clauses (m), (o) and (q) of sub-section (1) recite deductions not allowed and are prohibitive, except that discretion is given to "the Minister," while clauses (a), (b) and (c) of sub-section (3), deal with the determination of the cost of a mine on which depletion shall be allowed. It would not appear that the provisions of sub-section (1) and (3) referred to above contain anything that would prevent the adoption by "the Minister" of the plan outlined here.

There would however require to be included both in the Dominion and Provincial Acts provisions dealing with the following:

(1) Any allowance for depletion to be granted only if the company invests an equal amount of cash in trustee secur-

ities retaining such as a sinking fund, to be distributed only on the winding-up of the company.

(2) Final distribution in a winding-up not to be made until the company or its liquidator has paid tax on any amount by which the allowances granted for depletion and/or depreciation exceed the net cost of the assets after deducting all amounts received from sale or salvage.

In conclusion, while the plan outlined may appear to present certain departures from the existing methods of dealing with the taxation of mining companies by both the Dominion and the Province of British Columbia, it is believed that the suggested changes would give a more equitable basis both for a mining company and for its individual shareholders, and would provide a greater degree of stability to the mining industry.

SOME ASPECTS OF INVESTMENT TRUST ADMINISTRATION IN CANADA

By A. Ian Fleming, Chartered Accountant,
Montreal

THERE are different types of investment trust in operation, the principal ones being as follows:

The Management Trust formed for diversified investment purposes primarily for income.

The Management Trust formed for diversified investment purposes but with capital appreciation and trading in securities a dominant motive.

The Fixed Trust which is not really a company at all but a trust of fixed holdings divided into units permitting small investors to obtain diversified investment. The trust managers are usually remunerated out of revenues collected, etc. The advantage of a fixed trust is that the investor knows the underlying securities and is sure that they cannot be changed and the nature of his investment thereby be affected. On the other hand the rigidity of the fixed trust is not an advantage.

This article will not deal with fixed trusts but will concern itself with the management type of investment trust which is administered with a view to deriving income.

The investment trust has proved itself in Great Britain as a sound factor in the development of the financial life of the community. It has mobilized a large amount of capital under the capable direction of trained and skilled managers and this has contributed to the building up of enterprise and industry in Britain and the Empire as well as in various foreign countries. At the same time the small investor, as well as the large investor, has been provided with a useful vehicle for his funds which he has been able to entrust to the management of skilled men of high standing who specialize in investment work.

The history of investment trusts on the North American continent has been marred to some extent by certain abuses of the movement which need not be discussed now. The best safeguard for the investor in an investment trust is to be satisfied as to the calibre of those persons who are responsible for the management of the company.

The usual policy of a properly administered investment trust is to invest the funds with a view to providing over a long term a good return on the capital invested without endangering the capital. Naturally where numerous investments are held a company can afford to hold some speculative investments among its diversified holdings. Diversification is a stabilizing factor.

Some investment companies, of course, are less conservatively administered than others and quite rightly so, provided that the policy conforms to the wishes of the majority of security holders.

Some investment companies are capitalized with a simple structure of common stock only, while others have more complex structures with debenture issues and preferred shares as well. The particular form of capitalization generally adapts itself to the needs of each case as it arises.

Some Advantages of an Investment Trust

The administration of an investment company costs money and consequently some real advantage should be gained by the investor to warrant the placing of his funds in the hands of an investment company. Some of the advantages are as follows:

The advantage of skilled and continual supervision of the investments.

The advantage of diversification.

The advantage of having one holding of a diversified nature instead of numerous holdings; for succession duty purposes this is often important and saves endless trouble, expense and taxation which may arise if succession duty authorities in different parts of the world have to be satisfied before the securities can be released to the representatives of a deceased person.

In Great Britain an investor in an investment company does not suffer an increased burden of income tax over the investor who buys diversified securities direct. This is because the British income tax laws are so formed that double taxation is avoided. In Canada it is well known that a company's profits are taxed and that when the company pays a dividend the profits distributed are taxed again. While dividends from other Canadian companies are not taxed in the hands of a Canadian investment company, all foreign dividends and all bond interest, etc., are taxable. Consequently, in Canada the additional income tax burden is a further expense the weight of which has to be taken into account when considering the advantage of an investment company. There would appear to be some ground for Canadian investment companies, due to their nature, being exempted from income tax liability entirely, particularly as this additional burden is an important factor weighing against the development of an investment trust movement in Canada and such a movement would certainly be a constructive force in the country's financial life. In discussing this point it should perhaps be mentioned that reference is made to purely Canadian investment companies for Canadian investors. There have been many investment companies formed in Canada in recent years for investors residing outside Canada and there is special legislation in the *Dominion Income War Tax Act* covering such companies.

Chartered accountants by virtue of their training are well adapted to administer investment companies. In Great Britain many chartered accountants are engaged in this kind of work which calls for knowledge of financial conditions and markets, the ability to make quick investigation and interpret figures intelligently, a knowledge of income tax laws, preferably those of several countries, and familiarity with company law and secretarial duties.

Accounts of Investment Companies

The keeping of the accounts of investment companies is a relatively simple task especially compared with the complicated accounting practice required for many manufacturing concerns. Nevertheless there are many interesting points and problems. It is important to keep books and accounts in a manner which permits speedy assimilation of figures required for different purposes. For instance, it is generally useful to keep a revenue schedule showing the income from each investment. This not only proves very useful for collecting essential information for income tax purposes but it is a distinct aid to auditors and others in checking revenues.

The accountant is well trained in distinguishing between capital and income. In keeping the accounts of investment companies many problems arise calling for careful consideration of this necessary distinction.

Interest—It is well known that interest accrues from day to day and dividends do not, and consequently when a bond or debenture is purchased or sold the accrued interest is generally separated from the price and debited or credited to income. In Canada and the United States of America bonds are dealt in and quoted with the interest separated from the principal except when interest is in default when the bonds are quoted "flat." In Britain the quoted price always includes any accrued interest. In practice when bonds which are paying interest are purchased the accrued interest is set up at its full face value, and when interest is in default nothing is set up. Actually, however, this treatment may be theoretically incorrect; for instance a bond may be selling at 60 in anticipation of its passing its interest and yet the accrued interest is given its full face value. If the coupon was sold separately from the bond it might be found to fetch only 30% of its face value and later on it might be found that the interest was passed. The proper treatment of discount or premium on bonds calls for careful consideration. In the case of bonds bought at a premium the premium should be written off against interest receipts over the life of the bond to its maturity date under strictly correct accounting practice. In the case of bonds bought at a discount the position is more difficult. While it is unwise to anticipate the eventual

increase in amount, there is no doubt that in the case of high grade bonds such increase is reasonably sure and it is taken into account fully when the managers consider the yield on the bond when its purchase is being decided. In such cases it is permissible to take credit for the discount over its term, but in the case of lower grade or speculative bonds such treatment is certainly improper. The accountant must use his own judgment in determining this question.

Dividends — Again, it is the recognized practice that dividends should not be accrued when buying and selling shares and recording the transactions; yet a share may be purchased a day or two before it goes ex-dividend, after which the price drops by the approximate amount of the dividend. From a strictly correct accounting viewpoint the dividend should perhaps be credited to capital, though in practice this is seldom done. Similar problems arise in cases where a company may be paying dividends and not earning them, thus reducing its surplus. An investment company may purchase shares in such a company and the proper treatment of such dividends must be given consideration. Or an investment company may purchase a preferred stock carrying large dividend arrears and shortly afterwards a large dividend may be paid on account of arrears. It is quite obvious that each case has to be examined on its merits and that there is no hard and fast rule for dividing items between capital and income. All the surrounding circumstances must be considered and even then the decision often may be purely a matter of opinion regarding which differences may be found to exist. As a rule, however, the cases where doubt exists do not involve large amounts in proportion to the total revenue and the accountant responsible need not waste his time in splitting hairs. However, he has to keep a watchful eye on things. Dividends from mining companies should also be watched carefully with a view to crediting some portion of such receipts to capital in view of the wasting character of these concerns. It is an almost impossible task to determine accurately the proper depletion or amortisation allowance in most cases, but that is no excuse for ignoring the matter. Where mining dividends are important in amount this subject should receive some attention. Proper consideration of this problem calls for some knowledge of the mining properties.

Stock Dividends—The proper treatment of stock dividends in the accounts of investment companies is a subject upon which a whole article could be written. Stock dividends may take several forms such as (1) the issue of common shares to common shareholders, (2) the issue of preferred shares to common shareholders, (3) the issue of debentures to common or preferred shareholders.

1. Issue of Common Shares to Common Shareholders—

From a proper accounting point of view such dividends should not be given a dollar value. The number of new shares should be added to the investment account and the book value of the investment should remain unaltered. Any sale of a fraction should be credited to the investment account in the same manner as any other sale. Stock dividends of this nature are not dividends at all as the paying company has not parted with any of its property or assets and the position of the shareholder is not changed by the issue of the new shares. His proportionate interest in the company's equity remains the same. If, however, the shareholders are given the option to receive cash, the cash amount applicable should be treated as a dividend and the investment account debited accordingly as this is equivalent to payment of an ordinary dividend and a subscription to new shares.

2. Issue of Preferred Shares to Common Shareholders—

This type of stock dividend has become quite common since the passing of the United States laws enforcing a tax on undistributed profits. Under United States law the payment of stock dividends of this type qualifies as a distribution and consequently companies desiring to conserve cash often issue preferred stock and capitalize part of their profits and thus escape the undistributed profits tax. There is room for plenty of argument as to whether such dividends should be credited to revenue or not. On the one hand the paying company has clearly not distributed any of its assets and therefore no dividend in the proper sense of the word has been paid. On the other hand it cannot be said that the position of the shareholder is unchanged. He still owns all the equity of the company, but if there were other preferred shareholders prior to the stock dividend, the declaration of the stock dividend has clearly diluted their prefer-

ence in favour of the common shareholders. Notwithstanding this, however, the writer believes the conservative way to treat such dividends is to credit nothing to income. The question arises, however, how the new shares should be valued. The following argument and method are suggested as offering the correct solution:—The cost of the original investment and the new preferred shares received is still the cost of the original investment and it therefore becomes necessary to apportion such cost over the two holdings; as a basis of apportionment it is suggested that the relative market values of the two holdings at the time of the payment of the stock dividend be obtained and used.

3. Issue of Debentures to Common or Preferred Shareholders—This type of transaction differs from both the two already discussed. In this case the shareholder is made a creditor of the company, and it would appear that a proper dividend had been paid in the sense that a segregation of assets is taking place although the date of actual segregation is deferred. It is interesting to bear in mind, however, that in recent years the British law courts have held that such stock dividends are not taxable income. The writer would prefer not to state whether such stock dividends should be credited to income. If they are not so credited, they should be treated like preferred shares issued to common shareholders.

Transfer of Securities of Other Companies—This type of transaction, though sometimes called a stock dividend, is plainly a dividend in the true sense of the word; the company is dividing part of its assets amongst the shareholders and the new securities should be given their current value and the same should be credited to income.

It should be noted that under the Canadian income tax laws stock dividends are included in the term "dividends" and are accordingly taxable income. The *Income War Tax Act* lays down no basis of taxation, however, for such debatable transactions and the income tax officials base their assessments on the rulings adopted by the Commissioner of Income Tax. At the present time it is believed that the rulings are such that Canadian stock dividends are valued according to the amount per share of surplus (capital and earned) which is capitalized in the books of the paying

company upon payment of the stock dividend, but that foreign stock dividends are valued at their market value when received. It would be interesting if some taxpayer were to take these questions before the courts.

Investments Recorded at Cost

As a general rule investment companies make it a policy to keep their investments at cost, though often sales made at a profit are used to write down the value of any remaining shares of the same issue instead of being credited to investment reserve or capital surplus. It is probably better to transfer all gains or losses on sales to investment reserve or capital surplus and thereby keep the actual holdings at cost; this policy at least has the advantage that the books show the actual cost while if it is desired to show the investments below cost by reducing their value by any profits realized nothing prevents this being done in the balance sheet. It is important to keep investments at or below cost so as to avoid losses being hidden in the book value of remaining shares.

Accounts should, of course, be kept in such a way that dividends will not be paid which will impair the capital of the company. Investment companies, however, are in a somewhat different position from commercial companies in this regard in that, as a general rule, their investments which are their "fixed" assets (although the term is not appropriate) are really liquid assets and capable of fairly accurate valuation and quick realization. Consequently, the importance of the book values being kept at or below cost is perhaps academic as the market valuation of the investments is the important figure and unlike industrial concerns the cost of the fixed assets does not have to be written down over the life of such assets and provision made for replacement. It is not being suggested that the market value should be relied upon as the true value of the assets as it is well known that market values are often far too high and often far too low. However, such value is of more interest and importance than a book value or cost which may be years old, or which may be yesterday's, depending on the accident of dates of purchase and sale.

It is probably true to say that an investment company of which the securities have fallen in value well below cost should refrain from paying dividends unless a reserve or

surplus exists to cover the difference between book value and market value. Proper accounting, however, demands that investments should be kept at or below cost and it is suggested that this be done. If investments have fallen in value it is hard to argue that capital has not been lost just because the securities have not actually been sold. If A company and B company both buy 100 shares of General Motors at 60, and A sells at 50 and later repurchases at 50 and B does not sell, the result would be that A's books would show 100 General Motors at a cost of \$5,000 and a realized loss of \$1,000, whereas B's would show cost of \$6,000 and no loss, which is hardly logical. This example is mentioned in order to stress the point that cost of investments, while necessary to record for historical and accounting purposes, is of less interest than market value in the case of easily realizable assets such as the usual portfolio of an investment trust.

It is unwise to let the cost of an investment be a factor in determining whether or not it should be sold or more shares bought. Cost is "water under the bridge" and has no bearing whatever on the relation of present price to prospects. To take a simple illustration, suppose investment company A bought 1,000 shares of a stock years ago and paid \$30,000.00 therefor and company B bought 1,000 shares of the same stock last year and paid \$7,000.00 for them. If sound judgment indicated that the stock should be sold at current levels of 8 it would be illogical and unwise for the directors of company A to refrain from selling because of the loss that would be realized. The loss is already there.

Foreign Exchange

The treatment of foreign exchange in investment companies is a subject upon which a special article could be written. However, it is suggested that a convenient method is to enter all transactions in foreign currencies at their current day-to-day value and to treat fluctuations in the value of foreign currency balances as an addition to or reduction of capital by debiting or crediting such accounts as investment reserve or capital surplus. It is believed that if this policy is carried out consistently and revenues entered at their correct value at date of receipt, the Canadian income tax officials will be satisfied and will regard further fluctuations in the value of foreign cash balances as capital. United States revenues collected and maintained in a United

States dollar account could be entered at par unless the United States dollar premium rises over, say, one or two per cent. Exchange premiums on dividends and interest should be credited to revenue in a separate account from dividends or interest in order to facilitate the checking of revenue. However, if the premium or discount becomes important in amount one should remember to group the same with the respective revenue item for purposes of income tax in claiming such allowances as depletion or in determining the total income from a particular country for purposes of reciprocal tax relief.

Considerably more on this subject of investment companies could be written but this article has dealt with some of the features of interest to accountants whose work brings them into contact with such companies.

SOME OBSERVATIONS ON THE PROFESSION*

By George Cochrane, Chartered Accountant,
New York City

Mr. President, Chief Justice Greenshields
and Gentlemen:

Please allow me first of all to thank you sincerely for the honour you have done me in inviting me to speak before you this evening, an honour which I feel is all the greater in that it comes from my fellow-members, as I am proud of being a chartered accountant of the Province of Quebec.

I am sure you have all encountered difficulty in settling upon a suitable subject for remarks to be made before fellow chartered accountants. This difficulty I have experienced in that all subjects of professional interest are so much a part of our lives as to become commonplace.

This fact in itself is, of course, an indication of the place our work fills in the society of our day. We deal with the commonplace of the everyday life of our neighbours as it is accounted for in the records of business. Those who bring about the transactions which are daily recorded do not always understand their effect and it is one

*An address given at mid-year dinner of the Society of Chartered Accountants of the Province of Quebec held in Montreal 19th December 1938.

of our duties to report these for their understanding in statement and language in the instruments of our profession.

Position in Civil Life

In the course of my remarks at the annual meeting of the Dominion Association in Halifax last August, I pointed out the part which our fellow practitioners in Great Britain are called upon to play in the civic life of that country and I feel that it is not inappropriate again to call attention to this phase of our usefulness.

The profession in the Dominion and the United States has, perhaps, been so busy establishing itself and building those things so essential to the creation and operation of a sound professional body that it has not had time to devote to the outside activities of civil life and has been content to leave these matters to others. It seems to me the time has come when this should be altered. In many instances, the second generation in Canada is now grown up and trained in the science and art of accounting and your businesses and reputations in your profession are so established that you may turn and seek your rightful place in other fields.

There are many problems facing all of us in these days, international and national problems affecting our foreign and domestic relationships, and to their solution all the genius of our time must be focused.

In the solution of a problem one of the first steps should be to establish the facts.

Modesty should not restrain us from a realization that our training and practice fit us as well as any and better than most, to render disinterested service in the establishment of facts and to present them in simple and understandable language and statement. In this field we can contribute to the end that a way may be found out of the morass of wrong thinking and worse action in which our world seems to be lost.

Government under our democratic system is not something separate and detached from those governed but is the servant of the people who, as the master, have a duty to see that government carries out its duties properly and adequately. In turn, government should be able to look to the people for direction as to what duties should be under-

taken and what problems it should attempt to solve. For this purpose government sets up commissions or committees of inquiry and, in such activities, we can be helpful and should make it clear that we are available to serve. I noticed in THE CANADIAN CHARTERED ACCOUNTANT some time ago that the Government of this Province called upon two prominent members of your Society, Mr. George C. McDonald and Mr. J. A. Larue, to act on a commission to examine into and report on taxation in the Province of Quebec. I think the Society should be proud of these selections and the Government should be congratulated on the wisdom of its action. The public has such confidence in our independence of inquiry and judgment that our inclusion on such commissions and committees cannot but add to the acceptability of their conclusions. Industry and business in all their ramifications are familiar subjects of our continuous professional inquiry and, while those actually conducting their activities may be subject to some suspicion as being self-interested, our position we have shown, and will continue to show, is that of complete independence and our objective the presentation of the facts as we see them. Wages, labour relations, business methods are all subjects of immediate consequence in the solution of our present day perplexities. Who is better fitted than the chartered accountant to help in arriving at an answer to questions on these subjects?

Function of Financial Statements

At a meeting of this character, when we are all accountants together, you will, I hope, feel that it is not out of place for me to refer to one matter in which, in my opinion, there has been a trend to over-emphasis.

Balance sheets and profit and loss accounts are not statements of precise measure but are compilations expressing opinion in accordance with certain accepted conventions, of the data of industry and finance. These statements are today, and have been for centuries, well understood by business men and, while still capable of much improvement, serve their purpose remarkably well. However, we should not allow the lay public to place a reliance on these statements greater than the statements deserve, or the unacquainted to use them for purposes for which they are neither designed nor intended.

One would hardly believe it possible, but I heard the other day of a judge during a certain proceeding who said to an accountant witness, "Mr. Accountant, do you mean to tell me that I cannot divide the amounts set opposite the capital and surplus of any balance sheet certified by a chartered accountant, by the number of shares outstanding and thus arrive at what my shares are worth?" and when the accountant informed the judge that was so, the judge said he was extremely surprised and disappointed as he had been acting on that assumption for many years.

Yet, while it is important for us to remember that our province as accountants has its boundaries, there is assuredly no reason for us to deplore our limitations on that account.

Rules and Standards

I recall some years ago reading a layman's conception of a professional accountant expressed in a letter in which he said "A public accountant should be a friend to the erring; a schoolmaster to the ignorant; a spur to the indolent; a warning to the trickster; an eye-opener to the wide-awake; and a guide to heaven."

In the face of that some of you may perhaps feel, as I did, that our shortcomings must be greater than we had supposed.

Be that as it may, it is well that we should recognize that the soundness of this science of ours and the effectiveness of the art with which we apply it in our everyday work is largely dependent upon the extent to which the conventional rules or standards keep pace with the changing conditions of the time.

And herein, it seems to me, lies a need in our profession at the present time.

I refer to the need for systematized review and criticism of these conventional rules and standards.

These accounting conventions, these rules of sound accounting, as they have come to be known and which represent the doctrine in which we believe, have met with general acceptance outside the profession which is in some respects more absolute than deserved, more unqualified than we have intended.

Even as it is our strength that the principles on which we work are generally accepted, so also is it liable to become

our weakness if we do not see to it that our practice is developed, advanced and adapted in accordance with the soundest thought of our day.

Let us make no mistake about it—evolutionary changes cannot but require and constantly are requiring reconsidered and fresh interpretation of the basic rules upon which the science of accountancy depends.

Threat of Bureaucracy

The present bureaucratic age is all too prolific of bodies with dictatorial powers, and the possible effect upon the profession of edicts handed down from such bodies which express opinions on matters which are essentially in our own province is very obvious.

Our most precious possession is our freedom of thought and independence of action. But of what value are these if we do not seek to make the best possible use of them.

It is one of our responsibilities to find means whereby our considered views, the results of criticism and discussion amongst ourselves, may be effectively brought into the open to influence those to whom the power to dictate has been given.

I was much impressed, earlier this year, by a paper written by Mr. A. A. Berle, Junior, under the title "Accounting and the Law."

Its stated purpose was to stimulate the systematic development of rules of accounting and on this subject he brought out much that was of interest. It is probable that many of you have read the paper in question but I should like to quote from it a passage which seems to me particularly appropriate at this time.

After expressing the fervent hope that theoretical and professional discussion amongst accountants will continue to be fertile, Mr. Berle continues,

"The only practicable method of checking a foolish or unwise administrative ruling on accounting is in the technical journals and the proceedings of the associations. In the law we know that the long process of recorded study ultimately serves as a corrective upon the most powerful courts; and the case for that correction is infinitely stronger in a relatively new field like that of accountancy."

The passage you have just heard was taken, as I have said, from a paper which dealt with certain aspects of accounting in its more literal sense and its significance was therefore limited.

But I want to leave with you tonight the suggestion that it need not be confined to its narrowest application.

Rulings of one kind and another are daily being issued by administrative bodies, many of them far removed from accountancy in its strictest sense, yet well within the scope of those subjects our experience of which fits us to offer authoritative criticism.

Taxation in all its branches is surely a matter upon which the chartered accountant is well equipped to speak with knowledge.

If, then, there are points of divergent opinion between present administrative ruling and the considered professional view, based both on established theory and practical experience, is it not the duty of the profession to see that its contentions become more openly known?

The theory underlying the taxation treatment of many quite commonplace items is, under present regulations, often at singular variance with what we should term sound accounting principles.

Who amongst us has not in his everyday practice met with cases where the application of taxation according to prescribed rule has produced a position so inequitable as to amount almost to discrimination? A position, moreover, which, it may be, was completely unforeseen by those responsible for the regulations which brought it about.

These and similar things, it seems to me, are proper and necessary matters towards the revision of which we should contribute so far as possible our corrective influence.

Recent Graduates

May I, at this time, be allowed to add my congratulations to those already offered to the gentlemen who are here this evening to receive the evidence of their hard work in passing the final examination?

They now enter on the stage of further expansion of knowledge through the everyday application of those things which they have learned in theory. Our profession is both a science and an art, a science in that it is based on a

knowledge of doctrines of principle, interrelated and interdependent, and an art in that it is necessary to have experience in application and practice in presentation. I would like to call their attention to the fact that much of the teaching which they have received and the majority of the text books which they have used have come from the hard work and clear thought of the practising accountant. That such benefits have been received carries the responsibility to assume the task and in turn pass on and improve the science and art of accounting.

When speaking in the presence of accounting students, and, I believe that we all should be students, I like to refer to an oft repeated warning which my teachers gave me. As part of our training, as you well know, it has been considered necessary for us to study law, the law of companies, the law of estates, contracts, partnership law, etc., and these subjects are taught to us by lawyers in the same manner and to much the same extent that they are taught to law students. It is, indeed, very necessary that we should have a sound grounding in those parts of the law which we continually meet in our daily practice. But, and this is the warning, we do not learn law so that we can advise our clients on legal questions. We learn law so that we can recognize when the advice of a lawyer is necessary and to make us understanding and intelligent clients when we seek such advice.

National Professional Society

In the United States we have in the last two years made a forward step of great importance in that today we have one national society, the American Institute of Accountants, in which all members of the State societies are entitled to be members.

In this respect you were wise more quickly than we were in that you have for some years had the Dominion Association. It seems to me eminently desirable that we should have one national society because our views, to become most effective, must be expressed with unanimity and the national body, acting as a clearing house for bringing divergent views into reconciliation, can set standards of qualification to the end that our members may truly merit the prestige that the title Chartered Accountant carries.

It must be remembered that one cannot expect to get out of any organization such as ours any more than he

puts in, and the success of our professional societies in their efforts for us individually and for the profession as a whole will largely depend on the support they receive from the chartered accountant wherever he may be.

From my close personal contact I can assure you that the amount of work entailed upon the acceptance of a position on the council or as an officer of a society is considerable and that a great amount of time and labour is unselfishly devoted to obtaining the results which the societies have obtained, not only for the members of the societies but for the chartered accountant everywhere. Gentlemen, these societies have a right to demand your participation in the work from which we all benefit, a participation at least to the extent of membership in our provincial and national societies.

Professional Ethics

In conclusion I would like to touch upon a phase of our professional life which is, I believe, the essence of our achievement to date and will continue to be the basis of all future advancement. I refer to the adoption of a code of sound ethics.

Those who have preceded us took the position that our conduct must be judged by the highest standards of integrity, honesty, and independence and that our relations to one another must always be able to bear the closest scrutiny.

There may have been cases in which we have failed to live up to such standards but in the fifty years of the life of our professional societies such cases have been few. It is in the hands of the officers of such societies as the Society of Chartered Accountants of the Province of Quebec that the ethical standards we have adopted have to be administered but it is in the hearts and minds of its individual members that these standards must live and thrive and, I believe, we can without immodesty congratulate ourselves that this Society does not fail in this respect.

Gentlemen, I thank you sincerely for the kindness you have done me in listening to my remarks, for your kindness in granting me the opportunity of meeting you again, and for the gracious entertainment of this dinner. May I wish you all a very happy Christmas and a prosperous New Year.

THE AUDITOR'S REPORT TO THE SHAREHOLDERS

By C. A. Ashley, B.Com., C.A., Toronto

THE report of the discussion on this subject at the annual meeting and the other material which has recently appeared in THE CANADIAN CHARTERED ACCOUNTANT cannot fail to be of interest and importance to all chartered accountants and, indirectly, to shareholders.

Shareholders are interested only indirectly because they are not trained accountants and have little idea of what it is all about, and this is an important fact. Chartered accountants are appointed to audit the accounts of companies precisely because they are experts in whom the shareholders can place trust. That trust is not fulfilled if the auditor throws back a technical problem for each shareholder to solve for himself.

The advantages of what may be called the "conventional" report are:

1. It satisfies exactly the requirements of the act.
2. It is short and its wording is well known; and any variation therefore stands out clearly and attracts attention.
3. It acknowledges that the auditor has accepted full responsibility for deciding what work he must do to enable him to express the opinion contained in the report.

The form of report recommended by Mr. G. O. May's committee to the New York Stock Exchange contains the following: "... we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions. In our opinion, based upon such examination" This is an acknowledgment of the fact that auditors now seldom do detailed audits. But the reason is that, relying on the internal check, they can form their opinion without making a detailed audit. The auditor is not primarily concerned with his legal liabilities, but it is worth considering whether this form of words would relieve the auditor from liability if the internal check was so poor as to make a test

less than what a "reasonably competent, careful and cautious auditor" would do. The attitude of the shareholder might be expressed: "I care little what you have done because I am not competent to judge whether it is adequate or not. You were appointed to express an opinion and I presume you have done what you thought necessary to enable you to express that opinion."

Later, the report states ".... the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review" The memorandum in the July 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT asks: "Is it desirable to adopt the phrase 'in accordance with accepted principles of accounting' in the absence of a recognized set of accounting principles?" The reply to this is that, although there is no recognized set of accounting principles, certain principles can be established, and if established should be maintained. "Accepted principles consistently maintained" must be taken as a whole. Principles must be used which may not be universally accepted but which must be reasonable, and they must be used continuously.

The wording of the report is not satisfactory on this point, for it is not consistent application of principles during a year which is often in doubt; it is their consistent application from one year to another. Unless methods are consistent from year to year the whole of the accounts are worthless, and this is the very point upon which most doubt is thrown by those who study accounts.

The samples of auditors' reports given at pages 135-139 of THE CANADIAN CHARTERED ACCOUNTANT for August 1938 suggest the following comments:

2. "We have verified the securities representing the investments of the Company." Why give details about this particular item? Unnecessary.
3. "... a true and correct view of the combined affairs of the and its wholly owned Subsidiary Companies, after making provision of \$430,575.18 on account of depreciation for the year"

Ambiguous. Presumably it is meant to avoid responsibility for the correctness of the provision

for depreciation, whereas it may be read to confirm it. If the confirmation is intended, it is unnecessary.

4. "The Inventories of Stock on Hand, as certified by responsible officials of the various Companies, have been valued on a conservative basis."

How much better this would be if it said that the valuation was in accordance with accepted accounting principles consistently applied over a period of years! A "conservative basis" is not definite enough to be an accounting principle.

8. "... we have satisfied ourselves that proper supervision over the detailed accounting records is being exercised by the Company's Internal Audit staff."

Interesting as showing a trend, but unnecessary.

9. "The Cash, Bank Balances, Investment Securities and Call Loans have been verified by inspection or by certificates from Depositories." It is for the auditor (not the shareholder) to decide whether to accept such a certificate.
10. Very similar to 9.
11. "Subject to the sufficiency of the reserve for depreciation and amortization of franchises and other assets" Whether this is satisfactory can be determined only by seeing the accounts on which the report was made.

Two of the most important points in accounts are depreciation and inventories. The annual charge for depreciation should be calculated on the same basis year after year, and if this is not done specific attention should be drawn to this by the auditor in his report. The present methods are so unsatisfactory that it would possibly be better if no charges for depreciation were made, and it were left to directors to keep undistributed profits aside with depreciation in mind. The method of inventory valuation should be reasonable and consistently applied year after year. Without this the accounts are worse than useless: they are misleading. A considerable amount of evidence is available to show that auditors have allowed amazing deviations from this rule to pass unchallenged in their reports.

Is any of this discussion worth while until the auditor's attitude to secret reserves has been made clear?

FURTHER REFERENCES TO AUDITORS' REPORTS AND THE EXAMINATION OF FINANCIAL STATEMENTS

The discussion of auditors' reports continues in this month's issue, and we take the opportunity of reproducing some observations of those outside the profession. The layman's opinion on the subject should be of interest to our readers. The first article is by A. D. Ellwood of *The Financial Post*, Toronto, who, after referring to the public interest aroused in accounts through the revelations in the McKesson & Robbins case in the United States, writes as follows:

Soundness of audits is essential to investors, and auditors in Canada have achieved an enviable reputation.

In this country auditors are responsible to, and elected by, shareholders. In the United States their primary responsibility is to the management.

The Dominion Companies Act specifies information which auditors must provide for shareholders. There has been built up a somewhat standard practice although in the final analysis auditors' work remains a matter of opinion.

Within the verbiage of an auditor's report the shareholders should look carefully for information. To a trained reader there are sometimes suggestions that might lead to interesting questions at annual meetings.

Depreciation Questioned

The investor should remember that the Dominion income tax department is pretty efficient in seeing that companies do not charge more depreciation than tax regulations permit. Thus when the matter of depreciation is specifically mentioned in an auditor's certificate the chances are that the auditor has questioned the adequacy of the year's provision.

Take this recent example:

"Depreciation provided includes an amount calculated on a per ton basis on newsprint manufactured to cover depreciation of paper mill, paper mill machinery and subsidiary buildings."

Now it is probable that the auditor had some doubts as to the adequacy of the depreciation provision. He may have felt that at a time when the mill was operating at 25% of capacity the provision was inadequate and when near-capacity operations were being carried on it was too high. Then the important factor of obsolescence may not have been given enough weight as a paper mill becomes less valuable each year, whether operating or not. In this case it would appear that the auditor doubts the efficiency of the methods of calculating depreciation. He may not feel in a position to make his objections too definite but he hopes that some inquisitive shareholder will seek more information on this point at the annual meeting.

Another Way

Another example. Certifying to a consolidated balance sheet the auditor states that it "is properly drawn up so as to exhibit a true and correct view of the state of the combined affairs of the . . . and

its wholly owned subsidiary companies, after making provision of \$430,576 on account of depreciation for the year."

Again this report suggests that the depreciation provision has not been what it should have been. Unfortunately, it does not state definitely whether or not the auditor thinks the charge is too small or too great, although it is most likely the former. But such a statement in an auditor's certificate should give curious shareholders an excuse to ask questions.

Here is an example of a different nature: "The inventories of crude oil and refined products are valued on the attached balance sheet on the basis of cost of crude oil, which was approximately \$650,000 higher than replacement value as at Dec. 31, 1937; the net profit shown for the year 1937 is therefore greater by this amount than it would have been had the inventories been valued on the basis of cost or replacement, whichever was lower."

This example is more definite than are most of the hints contained in auditors' certificates. Under ordinary practice, inventories are valued at the lower of cost or replacement value for year-end balance sheet and profit and loss statements. But it is quite conceivable that the income tax department has again stepped in. The contention may be that these inventories of crude oil are not yet sold. No one can be certain that this loss will have to be accepted when an actual sale is made. Thus, the company may not be permitted to reduce the year's profits by this amount. Shareholders should recognize, however, that this condition exists and they may want some reassurance from directors that this apparent over-statement of profits is justified.

Accepting Official Statements

Inventories are of vital importance. The following phrase may be typical of references to this item: "The inventories of stock on hand, as certified by responsible officials of the various companies, have been valued on a conservative basis."

From this wording it is not altogether clear whether it is the auditors that claim the basis of valuing inventories is conservative or if company officials certify this is so.

But it brings out an important point. Auditors do not ordinarily make a physical check of inventories. They may do so if specifically requested and in any case should verify them sufficiently to be reasonably certain that the amounts of valuations are correct. Actually, however, it is regarded as the responsibility of company officials and the directors to see that an accurate record of inventories is kept. Then the responsible official provides the auditor with a certificate that the inventories actually exist and are worth the stated value. It is known that some auditors, on their own responsibility, may check inventories although not in detail. But often this is not possible when the goods are held at widely separated points.

Fixed Assets

It may be the valuation of permanent assets that should be questioned. A recent certificate stated: "subject to the values at which the fixed assets of the company are stated, the attached consolidated balance sheet presents, in our opinion, a true and correct statement of the affairs . . ."

It often happens that companies have acquired assets and included them in their balance sheets at values which are no longer a reasonably correct appraisal of their worth. This is something that shareholders should recognize and whenever they see a statement similar to that just quoted they should be justified in probing further.

Internal Audit Departments

Reference is often made to the work of the company's own internal audit department. Most large companies have their own auditors. This staff makes a detailed check on transactions. They are responsible to the management and the directors but not directly to the shareholders as is the case of independent auditors under Canadian practice. It is common practice for independent auditors to accept the work of the company's own audit staff for such items as movable plant, stores, accounts receivable and cash at branch offices.

Common in auditors' certificates is the following statement: "We examined or tested accounting records of the company and other supporting evidence, and obtained all the information and explanations which we required; we also made a general review of the accounting methods and of the operating and income accounts for the year but we did not make a detailed audit of the transactions."

In defining what is actually involved in carrying out the operations mentioned in this statement the greatest scope is offered for the opinion of the individual auditor to make itself felt. The extent of the tests thought necessary, for example, might vary with different auditors and the circumstances would have much to do with actions. The amount of the explanations and information required is not stated by regulation. The auditor should be satisfied that the financial statements to which he is certifying are correct.

A general review of accounting methods might be made desirable because of some change in methods of handling certain items. The auditor might express his opinion to the company on the methods used. It might mean a separate report on specific items.

Just what is involved in a detailed audit is hard to define. It is seldom that all transactions are verified but it is likely that careful checks were made for periods selected at random.

Professional Discussions

The form of auditors' reports was discussed at the last annual meeting of the Dominion Association of Chartered Accountants. One member said: "I think the extent of the examination should be stressed in whatever report be made. That is a most interesting point to the shareholders."

"It seems to me that the act assumes that sufficient examination will be made to enable the auditor to give a certificate substantially along the lines set out in the act. If he confines his examination to tests, or makes insufficient examination, and then qualifies his certificate in such a way as practically to destroy its value, he is simply evading the intention of the act. When this form of certificate is set out as an example or guide, or something that is really compulsory, there may be certain qualifications he may have to make, but I think the act assumes that a sufficient examination will be made to make it possible for the auditor to certify the accounts substantially in the form set out in the act."

The fact that these reports are the subject of discussion among members of the profession and others is sufficient reason to feel that present forms are not perfect. Perhaps something will come from the investigation now under way in the U.S. that can be adopted in this country.

But even as they stand at present, auditors' reports merit more study on the part of investors than they often receive.

The following editorial comments are reprinted from
The Wall Street Journal of 4th and 9th January last:

(4th January 1939)

Auditing the Books

It was inevitable that the McKesson & Robbins disclosures should raise the question of corporation audits by independent accountants, and the institution by the Securities and Exchange Commission of a broad inquiry into the facts in that case is a natural consequence. The subject is not by any means new. Forty years ago it was actively discussed as a result of circumstances more or less analogous to the present instance in both railroad and commercial cases. The practice of independent audit gradually became general; comparatively few reports of important corporations today are without such certificate.

What has, however, not been so general is a clear understanding by the public of the precise nature and scope of these audits, and the true significance of the resulting certificates. Some people apparently think that an auditor's certificate is the same thing as an appraisal of worth and a guarantee of value. In the simplest form an audit is merely a test of the correctness of the bookkeeping as a record of facts and a verification of such assets as bank cash, securities and other assets capable of such verification, without such a complicated and laborious process as, for instance, a physical verification of material inventories. A cash balance can be verified by a bank, securities can be counted, titles and leases can be examined, and vouchers checked against books.

But almost everywhere in the process somebody's word must ultimately be taken for something. No audit of large dimensions can be absolutely immune to forgery and lying, just as no law can absolutely prevent its own breach. The history of bank defalcations proves that to the hilt.

The whole value of an auditors' certificate depends upon its terms, which should indicate clearly and precisely what the auditors have done in checking the accounting and verifying the assets. It is one thing, for instance, to report that so much has been charged to operating expenses for depreciation, and quite another thing to say that *enough* has been so charged to maintain the integrity of invested capital.

If we are going to legislate on the subject (as we usually do after a horse has vanished from the stable), we shall do well to avoid the attempt to do too much by requiring of the independent auditor that he shall assume a responsibility beyond his power to discharge. No auditor—and no government bureau—can ever guarantee *value* in a corporate security. It is most important that this should be thoroughly understood by both legislators and the public. If we are to prescribe by law the contents of independent audit certificates, we had better proceed upon the principle of minima, if for no other reason than that it is easier to add to law in the light of experience than to repeal a law when it has proved unsatisfactory.

(9th January 1939)

Functions of an Auditor

At the monthly meeting of the New York State Chamber of Commerce held last week a resolution was offered recommending

that the independent auditors of corporation accounts should be elected by stockholders, instead of as at present being employed by the managements.

Stockholders in British corporations have done so for many years. One of the reasons for adoption of the practice was the assurance thereby given to stockholders that the profits were fully disclosed. In the light of this assurance they then declared the dividend. This function in Great Britain is reserved to stockholders; the directors may declare "interim" dividends, but final dividends are "recommended" only by them, and are made effective by vote of stockholders.

The British concept of the auditor's function was described some forty-two years ago by the British Court of Appeals in an opinion by Lord Lopes which reads in part as follows:

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful. . . . Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud, when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable."

An appropriate pendant to this is a resolution passed (May 10, 1934) by the New York State Society of Certified Public Accountants as follows:

"RESOLVED: That it is the sense of The New York State Society of Certified Public Accountants that, if a certified public accountant reports on a balance sheet of a concern over his signature without qualification or special explanation as to the item of merchandise inventories contained therein, it shall imply that he has exercised care in his examination by making accounting tests and checks of the concern's books of account and other available records pertaining to merchandise inventories, that he has received all information and explanations he has required from the officers and employees responsible for the taking and valuation of the merchandise inventories, and so far as accounting methods permit, has satisfied himself as to their substantial correctness, but that, as regards to the information and explanations he has required and as to ownership, physical quantities, description, quality, condition, marketability and valuation of the merchandise, he has relied upon the representation of the concern's management, subject to such checks as may have been obtainable from the records in respect thereto."

If we are going to overhaul the whole subject of independent audit of corporation accounts, the first thing to do is to lay down in

precise terms the nature and the scope of the function to be performed by the auditors, that is, *what they shall certify*. Lord Lopes' picturesque distinction between "watchdog" and "bloodhound" indicates a definite line of differentiation in the functions, and suggests that it is the directors who are charged with the "bloodhound" duties of detecting frauds that are not disclosed by books of account, and ordinary supporting data. The same concept is contained in the Society's resolution, and it has been the accepted principle of this practice from its inception.

If we wish to change this principle, if we wish to train watchdogs to perform as bloodhounds, let us by all means do so, but let us be sure that we know what we are doing, and how we propose to do it. Whether we change the principle or not, it is important at all times to understand the precise significance of such certificates as are furnished by independent auditors, so as to avoid reading into them things which are not and cannot be there.

Examination of Financial Statements

In an announcement to the press of the United States on 28th December last, the American Institute of Accountants, New York City, stated that, inasmuch as auditing procedure had evolved over the years and still remains in the process of evolution, the Institute would carefully review customary audit procedure with a view to determining what, if any, changes therein should be adopted by the profession in the light of the revelations in the McKesson and Robbins case. A copy of this announcement and of the statement presented by the committees of the American Institute and the New York State Society of Certified Public Accountants at a meeting which was called by the Honourable John J. Bennett, Jr., Attorney-General of the State of New York, on 6th January 1939 to discuss with persons qualified to discuss it the subject of the preparation of financial statements of large corporations, has been kindly furnished to the Dominion Association by the Secretary of the American Institute. Copies thereof have now been made by the Association and sent to the reference library of each of the nine Provincial Institutes. The following extracts are taken from the statement prepared for the meeting called by Mr. Bennett. This statement, it may be added, was also furnished to the United States press on 6th January.

Possible Improvements in Auditing

In discussing possible improvements in auditing, it must be borne in mind that no uniform audit procedure can be applied to all companies alike. While fundamental rules of auditing can be set out in considerable detail, there must remain a good deal of elasticity in application for the following reasons:

(a) In companies with inadequate internal accounting control a much more extensive examination by the independent auditor is necessary than in the case of large companies with highly effective systems of internal accounting control. In such cases, for example, the cashier will have no part in the entering of customers' accounts or the preparation of their statements, and neither he nor the ledger keeper will have authority to issue or approve credits to customers; the clerk recording the labor time and preparing the payroll will not be permitted to handle the funds; approval and entry of vouchers will be made by others than the disbursing officer; and stock records and inventory control will be kept independent of both the shipping and receiving departments. The extent to which these and other measures are practicable will naturally vary with the size of the organization and the personnel employed.

(b) The nature of operations of various types of business is so widely different that general rules of auditing procedure must be applied in varying degrees in each case. In a manufacturing or trading business, for instance, inventories are of relatively great importance in both the balance sheet and the statement of income; in an investment trust the confirmation of investment securities and the income therefrom are of prime importance; while in a public utility, questions involving the fixed assets, funded debt, plant additions, maintenance and fixed charges require particular attention.

It is therefore extremely doubtful whether any legislation or inflexible rules on the scope of audits would be practicable.

Inventories

There have been published recently in newspapers various suggestions regarding improvements in auditing procedure chiefly centering about inventories and accounts receivable. The accountant can do much through an examination of the accounting records and supporting documents to check the values and quantities of inventories. In fact, *Examination of Financial Statements by Independent Public Accountants*,* contains 24 paragraphs of suggested procedures in connection with inventories, approximately double the number relating to any other item on the balance sheet. In some cases it is possible for the auditor to supervise the physical count and tabulation of inventories, but in other cases it would be positively misleading, in our opinion, for an accountant to assume full responsibility for identification of items with respect to quality, quantity and condition of inventories. No one not a specialist in the type of business concerned, for example, could vouch for an inventory of ores, textiles or leaf tobacco. It has been suggested that auditors might employ experts in various fields to verify inventories for them, but such a procedure would mean merely acceptance by the auditor of another person's opinion. While no recommendations can be made with confidence at this time, the American Institute of Accountants and the New York State Society of Certified Public Accountants will continue to give careful consideration to this inventory problem.

Accounts Receivable

It has also been suggested in the newspapers that compulsory confirmation of accounts receivable might be desirable. As stated in the bulletin, *Examination of Financial Statements by Independent*

*Published by the American Institute of Accountants, 13 East 41st Street, New York City, 1936, paper, 48 pp., 15 cents.

Public Accountants, confirmation of accounts receivable by direct communication with the debtor is one of the most effective means of disclosing irregularities. In cases in which there are many thousands of outstanding accounts, this procedure will be costly unless reliance is placed on a test check. If there is other credible evidence of the existence and collectibility of accounts receivable, and there is no suspicion of any irregularity, auditors do not always feel it necessary to insist that their clients incur the expense of direct confirmation by mail. Continued consideration will be given to this problem by the accounting organizations, in the hope that practicable recommendations will emerge.

THE INCOME WAR TAX ACT

Filing of Consolidated Returns

On 10th January 1939 the Department of National Revenue, Ottawa, issued the following regulations respecting election by a Canadian parent company to file a return in which its profit or loss is consolidated with that of all of its subsidiary companies which carry on the same general class of business in Canada:

Whereas by subsection 3 of section 35 of the Income War Tax Act a company which owns or controls all of the capital stock (less directors' qualifying shares) of subsidiary companies which carry on the same general class of business and have fiscal periods substantially coincident with the owning or controlling company may, in respect of all such companies which carry on business in Canada, elect, before the commencement of the earliest fiscal period of any of the constituent companies in respect of which consolidation is desired and in such manner as may be prescribed by regulation under the said Act, to file a return in which its profit or loss is consolidated with that of all of its subsidiary companies carrying on business in Canada.

And whereas under subsection 2 of section 75 of the said Act the Minister may make any regulations deemed necessary for carrying the Act into effect.

Accordingly, the following regulations are prescribed in connection with the said subsection 2 of section 35:

1. Election shall be made by forwarding before the commencement of the earliest fiscal period of any of the constituent companies by registered mail to the Commissioner of Income Tax at Ottawa the following document in duplicate,—

A certified copy signed by an authorized officer of the company and bearing the company's seal, of a resolution passed by the board of directors of the company authorizing the election by the company to file a consolidated return in which the company's profit and loss and that of its subsidiaries carrying on business in Canada may be consolidated.

2. Once a company has elected to file a consolidated return, such election shall continue in force for all subsequent periods during which the parent and its subsidiary companies qualify for consolidation under the provisions of the said subsection 3 of section 35.

INCOME WAR TAX ACT

3. Where consolidated returns are accepted, the parent company must furnish annually with such consolidated return a separate financial statement including balance sheet and profit and loss account in respect of each company and in particular full details in respect of the depreciable assets and depreciation and depletion reserves of each of the companies included in the consolidated return in such a manner that the said assets and reserves of each constituent company may be clearly distinguished from that of any other company included in the consolidated return.

4. Any company which has already elected to file a consolidated return for past, current or future periods prior to the date of these Regulations and has forwarded the same to the Minister of National Revenue, Commissioner of Income Tax or the Income Tax Division and has received notice from the Commissioner of Income Tax that its said election has been accepted for income tax purposes, shall be deemed to have fully complied with the provisions of paragraph 1 of these Regulations. Such election shall be acted upon in respect of fiscal periods terminated before the date of these Regulations or any fiscal period current at the date of these Regulations and shall also be subject to all the other provisions contained in these Regulations.

5. Any company which has not already filed an election but has merely filed consolidated returns with the Income Tax Division is required to comply with the provisions of paragraph 1 of these Regulations by forwarding to the Commissioner of Income Tax a certified copy of the Resolution therein specified within ninety days from the date of these Regulations.

6. Any election to file consolidated returns by a company may be cancelled by forwarding to the Commissioner of Income Tax at Ottawa a certified copy signed by an authorized officer of the company and bearing the company's seal, of a Resolution passed by the board of directors of the company cancelling the company's election to file consolidated returns. Such resolution for cancellation must be passed and forwarded before the commencement of the earliest fiscal period of any of the constituent companies in respect of which separate returns are desired to be filed and will be acted upon by the Income Tax Division only in respect of such subsequent periods.

7. Once a company has elected to file consolidated returns and has subsequently cancelled such election, it will not be permitted thereafter to file consolidated returns for any subsequent period, notwithstanding that it may desire to elect to do so.

The right is reserved to issue such further regulations altering, amending and extending the foregoing as may from time to time be required or be deemed necessary.

Dated at Ottawa, this 10th day of January, A.D. 1939.

J. L. ILSLEY,
Minister of National Revenue.

C. F. ELLIOTT,
Commissioner of Income Tax.

GENERAL NOTES

Our Contributors This Month

Professor CHARLES ALLAN ASHLEY became a member of the Institute of Chartered Accountants in England and Wales in 1922, was an instructor at Queen's University in the following year, then returned to England where he engaged in the practice of his profession and served as foreign sales manager of a manufacturing company. He also had experience as an auditor in France and China before returning to Canada in 1930. He became a member of the Institute of Chartered Accountants of Ontario in 1931 and for the past four years has been supervisor of the course in commerce and finance at the University of Toronto.

A previous reference to GEORGE COCHRANE was made in the October 1938 issue when his address at the annual meeting of the Dominion Association was published.

ANDREW IAN FLEMING, who writes on "Some Aspects of Investment Trust Administration in Canada," was born in India and educated in England and Scotland where he was admitted to the Society of Accountants in Edinburgh in 1930. In that year he came to Canada and joined the staff of Messrs. Riddell, Stead, Graham & Hutchison with whom he is at present engaged. He became a member of the Society of Chartered Accountants of the Province of Quebec in 1938.

H. WYBURN GEORGE whose article "Some Thoughts on the Taxation of Mining Companies" appears in this issue came to Canada from England in 1910, and in 1911 joined the staff of Messrs. Riddell, Stead, Hodges and Winter at Vancouver, where he remained until 1924 with the exception of a period of overseas war service. He became a member of the Institute of Chartered Accountants of British Columbia in 1920 and is now in public practice on his own account in Vancouver.

W. H. Shaw Passes

We take this opportunity of paying respect to the memory of one whose name was familiar to a large number of the members of the profession some years ago. William Henry Shaw who passed away on 5th January at the age of 82

years was among the pioneers in instituting correspondence courses for students preparing for their chartered accountants' examinations. Practical experience in the office of a chartered accountant constitutes one of the essential parts of a student's training; the other is a thorough knowledge of the theory of accounts. It was in an endeavour to help students in this latter requirement that the late Mr. Shaw developed some thirty-five years ago his higher accountancy courses. With the assistance of the late David Hoskins, F.C.A., J. W. Westervelt, C.A., and W. S. Ferguson, C.A., he provided a much needed help to students up to about fifteen years ago when a number of the Provincial Institutes arranged for their own courses of instruction for registered students.

The name of W. H. Shaw belongs to that list of educationists whose service to his fellowmen is not soon forgotten.

Housing and Home Improvement Loans

According to a recent announcement of the Honourable Charles A. Dunning, Minister of Finance, approved loans under the *National Housing Act* at 31st December 1938, including those originating under the predecessor *Dominion Housing Act*, aggregated \$27,678,002. The total number of family housing units financed up to that time totalled 7,132 spread over 293 Canadian communities.

Mr. Dunning commented on the satisfactory results that were being produced under the amended act, pointing out that even in the last four months of the year, a period not favourable for building activity, new loans approved had totalled \$5,491,000. He anticipated a large increase in the volume of lending activity during 1939.

In addition to the above mentioned loans, Home Improvement loans reported to the Department of Finance up to 31st December 1938 numbered 61,299 with an aggregate value of \$24,480,127. In the month of December alone 2,391 new loans were made for home improvements amounting to \$958,622.

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Chattel mortgages—Bill of sale as security—Title to goods

(*Sexty v. Agnew*)

Saskatchewan Court of Appeal

A bill of sale absolute in form but intended as security will be treated as mortgage, and the Court will take into consideration all the circumstances surrounding the transaction to ascertain the true intention. The grantee has no right to seize the goods under such instrument as his property, and the seizure being illegal he is bound to return the property and liable in damages for the illegal detention. Consideration for the bill of sale was not allowed to be shown, on review, by affidavits of claim filed in a debt adjustment proceedings, not being conclusive evidence especially when not first offered at the trial Court.

Where a company joins with the owner as co-grantor in a bill of sale, no estoppel arises against the owner to deny title to the goods in the company where he made no representation as to ownership of the property by the company.—[1938] 4 D.L.R. 587.

Contracts—Discharge by sale—"Mining life of properties"

(*Northern Ontario Power Co. v. LaRoche Mines Ltd. et al.*)

Judicial Committee of the Privy Council

The contract of a mining company to purchase electricity from a power company "for the mining life of the properties" is terminated and brought to an end by its sale of the mining properties to another company which later operated and controlled them, thereby ceasing to be a "consumer" within the purview of that contract; it is therefore not a provable claim against the mining company which later went into voluntary liquidation. By virtue of statute the duration of such contract must be limited to ten years; but that will not entitle the power company to damages for the unexpired term of that period which came to an end with the sale of the properties.—[1938] 3 D.L.R. 657.

Executors—Allocation of shares as residuary legatee—Accounting for value

(Wood et al. v. Wood)

Judicial Committee of the Privy Council

Where the appropriation of shares by an executor in payment of his moiety as residuary legatee cannot be ascertained for want of executor's books, the fact of appropriation may be established by parol and documentary evidence; if the exact date of fixing their value cannot be ascertained, the executor will be charged with the highest value ruling in the month. Accordingly he must account for the difference between that value and the value at which he appropriated them, the sum to be divided between him and the other residuary legatees according to their moieties under the will, with interest at 5% to the latter.—[1938] 4 D.L.R. 1.

Municipal debentures—Moratorium—Provincial powers

(Day v. Victoria)

British Columbia Court of Appeal

A moratorium against actions within the Province on municipal debentures, which also reduces the rate of interest payable on them during the extended period, as a means of municipal debt refunding, is within provincial competence as to "property and civil rights" and "municipal institutions" within the Province. Such statute cannot be impugned on the ground that in pith and substance it affects the rights of bondholders outside of the Province, or as legislation on interest in conflict with Dominion powers. The Victoria City Debt Refunding Act as enacted by the Legislature of British Columbia held *intra vires*.—[1938] 4 D.L.R. 345.

Partnership—Liability of father and son

(Fancy v. Whynot et al.)

County Court, Nova Scotia

Father and son engaged in the same business are jointly liable as partners for a debt contracted in connection with that business, and the father cannot escape liability on the ground that he withdrew from the business and transferred it to the son prior to the debt without notice thereof to the public; where there is evidence that he promised to pay the debt he is primarily liable.—[1938] 3 D.L.R. 655.

Sales tax — Separate companies — Manufacturing arrangement—Calculation of tax

(Lapointe v. J. T. Wait Co. & Crystal Products Co.)

Quebec Superior Court

Where two companies, separate and distinct legal entities, manufacturers of cosmetics and toilet articles, the one carrying on its operations on the premises of the other for a fixed remuneration and each making separate sales tax returns based on the price of the goods sold to independent customers, entered into an arrangement whereby the one company manufactured the products of the other according to specifications on a cost plus basis and also acted as selling agent on commission, after which sales tax returns were put in by the one company alone calculated on the wholesale or bulk price to the other, such new method of operation cannot in the absence of positive proof to the contrary, be said to constitute a conspiracy to defeat the Government's legitimate claims. Even if such arrangement were for the purpose of lowering the tax payable that in itself would not make it legally objectionable.—[1938] 4 D.L.R. 418.

Trusts—Intermingling of trust funds—Prior lien of trust creditors

(Re Saskatchewan General Trusts Corp. Ltd.)

Saskatchewan Court of Appeal

Where a trustee mixes trust property with his own, the whole will be treated as trust property except in so far as he may be able to distinguish what is his own. Likewise where a trust company has intermingled trust funds with the funds of its general account, trust creditors upon liquidation of the company are entitled to a first lien and charge on the whole fund, in priority over other creditors, to be ratably distributed among such trust creditors in proportion to their claims until the trust accounts shall have been paid in full.—[1938] 3 D.L.R. 544.

PROVINCIAL NEWS

BRITISH COLUMBIA

The following are the successful candidates in the recent examinations of the Institute of Chartered Accountants of British Columbia.

Final: T. A. A. Fraser, Francis A. Griffiths, S. M. Horner, L. P. Kent and Brian W. Power.

Intermediate: A. H. Affleck, R. M. Bain, K. Cromer Bruce, D. F. H. Corbett, G. F. Dunn, A. P. Gardner, K. R. Genn, F. J. Holden, J. A. McIntyre, A. M. Reid, J. E. Robertson and J. W. Stephen.

The first and second place honours in the Final examination were won by Brian W. Power and Francis A. Griffiths respectively; and in the Intermediate examination by A. H. Affleck and G. F. Dunn.

Mr. J. Haydn Young, C.A., has been appointed by the Council of the British Columbia Institute to fill the council vacancy caused by the death of Mr. J. D. Small, C.A. Mr. Young has been elected also to the office of Vice-President of the Institute.

The January dinner and discussion meeting of the British Columbia Institute was held at Vancouver on Thursday, January 5th. The topics for discussion were the proposed standardization of education and examinations and the results of the recent examinations. Mr. E. C. Mapson, the President, presided and the discussion was led by Messrs. W. G. Rowe, E. H. Cotter and H. B. Hudson. Mr. Rowe, who was chairman of the Special Educational Committee, referred to the recent Inter-provincial Conference at Winnipeg dealing with standardization of examinations in accounting and auditing subjects throughout Canada and reported that tentative arrangements had been completed whereby it appeared possible that the uniform examinations would be commenced in the fall of this year. The speaker dealt at some length on the education of the students and pointed out that this was one of the main functions of our profession. It was his opinion that the future trend would be towards specialization in certain branches of the accounting field and that it would be necessary, with changed conditions, for our students to obtain a high state of efficiency. Mr. Rowe mentioned that closely

allied with the question of standard examinations was the matter of a uniform instruction course and that the local council now had this under consideration.

Messrs. E. H. Cotter and H. B. Hudson, both members of the local examining Board, spoke in praise of the proposal for a uniform examination throughout Canada and, in their review of the recent local results, gave instructive criticism of particular interest to the students, who were invited to be present.

Mr. Barrett-Lennard, Jr., President of the Students' Society, spoke briefly on behalf of the students and thanked the members for the opportunity of permitting them to attend the meeting.

The successful candidates at the recent examinations were introduced to the meeting.

The members took the opportunity of paying tribute to the memory of the late J. D. Small, who at the time of his decease was Vice-President of the British Columbia Institute.

ONTARIO

The Mid-Winter Banquet and Reception to students of the Ontario Institute will be held at the Royal York Hotel in Toronto on February 16th. Sir Gerald Campbell, K.C.M.G., High Commissioner for the United Kingdom in Canada, will be the guest speaker. Prizes and diplomas will be presented at this time to the successful candidates who wrote the examinations in December 1938.

QUEBEC

The annual mid-year dinner of the Society of Chartered Accountants of the Province of Quebec, to which brief reference was made in last month's issue, was held in the Windsor Hotel, Montreal, on Monday 19th December 1938. Maurice Samson, C.A., of Quebec City and President of the Society, occupied the chair and, after welcoming the year's graduating class as new members of the Society, tendered some sound advice to them on their responsibilities as members of the profession in Canada. Mr. A. F. C. Ross, C.A., proposed the toast to the guests, and Mr. Thomas J. Coonan, K.C., responded.

The meeting was addressed by the guest of honour, The Honourable R. A. E. Greenshields, Chief Justice of the

Province of Quebec, who spoke on the privileges of democratic power and emphasized the duty that lay with the citizens of a free democracy to assume the responsibilities which these great privileges imposed.

The Chief Justice was followed by Mr. George Cochrane, C.A., of Deloitte, Plender, Griffiths and Company, New York, whose address is published in this issue. Mr. Cochrane spoke briefly on matters pertaining to the profession and tendered some advice to the new members who had been admitted to the Society upon the successful passing of the recent final examinations.

Head table guests, in addition to Chief Justice Green-shields and Mr. Cochrane, included, Alex. Ballantyne, First Vice-President of the Society; John Bassett, President, *The Gazette*; L. J. Belnap, President, Consolidated Paper Corporation, Limited; A. H. Carr, Secretary-Treasurer, The Dominion Association of Chartered Accountants; B. W. P. Coghlin, President, Montreal Board of Trade; Thomas J. Coonan, K.C., Deputy, St. Lawrence Division, Minister without Portfolio; A. Cross, C.A., President, Dominion Steel and Coal Corporation, Limited; Kenneth W. Dalglish, a Past President of the Quebec Society of Chartered Accountants; S. G. Dobson, President, Canadian Bankers' Association; F. A. Doughty, Chairman, Montreal Branch, General Accountants Association; G. I. Gnaedinger, President, Quebec City Committee of The Society of Chartered Accountants of the Province of Quebec; Grant Johnson, Chairman, Montreal Stock Exchange; Dr. Henry Laureys, Vice-President, La Chambre de Commerce du District de Montréal; Beaudry Leman, President, Banque Canadienne Nationale; Gray Miller, President, Imperial Tobacco Company of Canada, Limited; Esdras Minville, Director, The School of Higher Commercial Studies; Henry G. Norman, Second Vice-President, Society of Chartered Accountants of the Province of Quebec; John Paterson, a Past President of the Quebec Society; L. E. Potvin, President, Quebec Municipal Commission; A. F. C. Ross, a Past President of the Dominion Association; A. H. Rowland, Inspector of Income Tax; P. F. Sise, President, Northern Electric Company, Limited; Alfred Smibert, C.A.; Prof. R. M. Sugars, Director, School of Commerce, McGill University; J. Stewart Walford, President, The Institute of Accountants and Auditors of the Province of Quebec.

SASKATCHEWAN

The following candidates were successful in the examinations recently conducted by the Institute of Chartered Accountants of Saskatchewan.

Final: W. F. Crutchlow, Saskatoon; J. I. Dickey, J. B. Lawson and J. S. Renouf, Regina; C. A. Fraser, Yorkton; D. S. Hutcheon, Kitchener, Ontario, and R. B. McInnis, Moose Jaw.

Intermediate: Thomas H. Shepherd, Regina.

J. G. Campbell and R. A. Frampton, Regina, passed Part I of the final examinations and N. Johnson was granted a supplemental in the final examination in Business Investigations.

PERSONALS

Mr. John Harvey, C.A., who for some years past has been supervisor of Corporation Income Tax under the Provincial Assessor at Vancouver, has been promoted to the position of Assistant Comptroller-General of British Columbia. Mr. Harvey consequently has moved to Victoria where he took up his new duties at the beginning of this year.

Messrs. Hudson, McMackin & Company, chartered accountants, announce that the business of their Halifax office will be carried on under the name of Hudson, McMackin & Grier, chartered accountants, with Mr. J. Esmond Grier, C.A., as resident partner.

Messrs. Sheper, Dobrin & Company, chartered accountants, announce the admission to partnership of Mr. Henry Dainow, B.Com., C.A., and the change in firm name to Sheper, Dobrin & Dainow, chartered accountants, with offices at Suite 607, Mayor Building, 1449 St. Alexander Street, Montreal.

BOOK REVIEWS

INDUSTRIAL RELATIONS

Papers presented at a Conference on Industrial Relations sponsored by Queen's University, September 14-17, 1938.

(Published by *Industrial Relations Section, Queen's University*, 1938, 128 pp., \$1.50)

This is a collection of papers and speeches delivered at the third annual conference of its kind held at Kingston. Those that will offer professional interest to the accountant are papers on industrial retirement plans by Dr. Bryce M. Stewart, Director of Research, Industrial Relations Counselors, Inc., New York, and J. A. Calder, Assistant Comptroller, Imperial Tobacco Company of Canada. Dr. Stewart speaking on the topic "Some Fundamental Features of a Good Retirement Plan," after setting forth the advantages of a formal as contrasted with an informal system, argues for an accounting arrangement whereby funds are set aside year by year concurrent with service rendered by employees rather than providing for them as they become due or through purchasing annuities for employees outright at dates of retirement. Not only do the accumulated funds afford assurance that retirement incomes will be forthcoming but "Pensions are usually related to employee earnings and their cost should, therefore, be related to earnings; (and) the accumulation of funds during the entire period of employee service entails a much lighter financial burden than the charging of pensions into expenses as they become due." He notes too with favour the trend away from the earlier practice of basing the amount of the pension on the employees' average earnings during the five or ten years immediately preceding retirement to that of basing them on his aggregate pay during the entire period of service.

Mr. Calder in his paper "Financing the Plan" lays down as a first principle "that the accumulated contributions must be irrevocably set aside to perform the function for which they were intended. . . ." Contributions should be affected through regular deductions from employees' wages and those of the company should be regarded as an obligation similar to the meeting of the payroll, being charged to operations in each accounting period.

Other papers in the volume deal with minimum and fair wage legislation, wage determination, employee training plans, work-sharing during depression, trends in employer-employee relations, a business man's view of industrial relations, and industrial relations and the university.

H. A. LOGAN.

University of Toronto,
6th January 1939.

THE LAW RELATING TO INCOME TAX OF THE DOMINION OF CANADA

By Herbert A. W. Plaxton, Barrister-at-law

(Published by *The Carswell Company, Limited*, Toronto, 1939, cloth, 350 pp., \$7.50)

This volume deals with Dominion Income Tax solely, and not with any of the Provincial tax statutes.

A book on that subject has long been overdue. Between the first and second editions of Plaxton & Varcoe's work on the Dominion *Income War Tax Act* almost a decade elapsed. Nearly another decade

has elapsed since the publication of the second edition. In that time much has happened affecting income tax law and practice. It is interesting to note that where Plaxton & Varcoe's second edition amounted to 418 pages (apart from the reprint of the Act) the book under review amounts to 264 pages. The explanation of the difference between the two lies apparently in the different treatment of the subject.

While both set out to analyze the provisions of the *Income War Tax Act*, Plaxton & Varcoe added comments and explanations. These are not supplied to the same extent by Mr. Plaxton. Indeed this work does not profess to supply them. Some sections are quoted without comment.

It is primarily a book for lawyers—the title implies that—and this is the place to find the law. In passing, this reviewer was unable to find a reference to the cases of the Hon. Dorothy Paget or the London & Provincial Trust. The decisions in these cases were of sufficient importance to cause the British Government to amend the Finance Act in 1938.

Naturally Mr. Plaxton does not deal with the practice of the Department of Income Tax to any large extent and yet it is precisely the practice of the Department that is important to an accountant. It would have been interesting to read comments on the Department's practice, for instance, with regard to the treatment of undistributed income earned before 1917 under Sections 18 and 19 and the taxation of stock dividends at market value or the taxation of the amount of capital surplus capitalized on payment of stock dividends.

Perusal of the Act as analyzed emphasizes again the large extent to which the taxpayer is governed by the Minister's opinion, and discretion.

This treatise is an excellent aid to the practitioner desirous of ascertaining the law relating to income tax and its value is not lessened by the useful cross references and indexing.

H. D. CLAPPERTON.

Montreal, 18th January 1939.

CORRESPONDENCE

The Editor,
The Canadian Chartered Accountant.

Montreal, 4th January 1939.

Dear Sir:

We are all naturally interested just now in the subject of audit reports and, in common with others, I read the article at pages 50 and 51 of your January issue, "Restricted Audit Report."

After giving the text of a letter from a correspondent, on the latter half of page 51 the Editor of "The Accountant" makes some remarks of his own and it is in this regard that I wish now to voice an opinion.

He says: "The unfortunate truth is that statute *has* laid down, in effect, the terms of the contract between members and auditor by requiring in specific and detailed terms a report on points clearly described by the section."

To me, and to others with whom I have discussed the matter of the government's requirements, the government's reference to the audit certificate is far from specific in its terms and I am inclined to believe that this is with purpose seeing that it is quite an impossibility to define the character of every class of audit with which the profession comes in contact. Even years ago when businesses were small and details were of a limited number, the audit, while covering

what might be generally termed as "everything," in fact did not go behind certain books of account and certainly did not include the checking of inventories, or the verification of accounts receivable by contact with the debtors unless under special authorization of the management. Likewise requisition forms for purchases were not consulted when covering vouchers for supplies.

Gradually, as business developed into larger organizations, the audit of detail became less and less until in most cases today it is largely a question of making tests, and I think I may safely say that nowadays there are very few of the old-time detailed audits.

I do not see how the statute could possibly be made to state in detail what course the audit must take. Even if it were stated that *everything* must be checked, who is going to define just what "everything" means or where it may stop? One may say that common sense would be the guide, but then what is common sense in the view of one man may be quite different in the mind of another. We all are constrained to using our best judgment. To check everything in most businesses today is entirely impractical from every point of view. We would have to duplicate the staff in the various offices, and every transaction from top to bottom, in branches as well as head office, would have to be covered; and who would be willing to pay the expense of that?

Seeing that of necessity there must be a limit placed on the scope of the audit and the scope of each be varied according to the nature and dimensions of the business, the only thing that remains is to qualify the auditor's report so as generally to define what scope the audit has taken. The main object of the practitioner today must be to have the auditor's report as intelligible as possible to the shareholders and in general terms so that if occasion arises where the shareholders think that for certain reasons the audit should cover a wider field of enquiry (with a consequent increase in the audit fee), they can order the directors, or managing director, to have such special examination made.

As suggested at the opening of this letter, I doubt that it would be wise for the government to do more than generalize as to what the auditor must do; but there should be some general understanding with the profession as to just what the reading of the certificate or report should be, so that the shareholders may clearly understand what form the audit has taken. One can appreciate that a report would not read very well, nor be acceptable to business at large, if it were to state in so many words: "Our audit was confined to, etc., for the reason that the managing director had stipulated in placing the audit that he would not pay more than, etc." In practice, however, as one knows, this is not uncommonly the way arrangements are made. It is very seldom indeed that the auditor is given *carte blanche* in the conduct of the audit and to charge just what he considers a reasonable fee.

Another point of difficulty is that if a fully detailed audit (whatever that means) has to be made to satisfy governmental requirements, it will immediately place the auditor in the position that all defalcations could be located at the starting point. That would virtually mean that the auditor in taking an assignment was ensuring his client against any loss because of embezzlement or anything of that nature and including, of course, the pilfering of merchandise from stock. One will agree that embezzlements will occur some time or other. Bonding companies have been formed to take care of this contingency and unfortunately some of the bonding companies, while collecting the premiums, seem desirous of making the auditor assume

the responsibility for their losses; and sometimes company managements, while restricting the scope of the audit to save expense, are not unwilling to throw the responsibility, if possible, on the shoulders of their auditors.

By all means let us have qualified certificates or reports in terms that will be quite clear and generally accepted by shareholders and business at large.

Yours sincerely,
F. W. Sharp.

OBITUARIES

The Late Robert K. Laidlaw, C.A.

The Society of Chartered Accountants of the Province of Quebec regrets to record the death of Mr. Robert K. Laidlaw, which occurred on New Year's Eve, at the age of forty years.

Mr. Laidlaw served his apprenticeship with Messrs. Riddell, Stead, Graham & Hutchison and after passing the final examination was admitted to membership in the Quebec Society in December 1925, after which he transferred to Messrs. Price, Waterhouse & Company, and later to Messrs. Hudson, McMackin & Company, Saint John, New Brunswick. In 1937 he entered the office of T. S. Simms & Company, Limited, Saint John, where he remained to the time of his death.

The Late James D. Small, C.A.

The Institute of Chartered Accountants of British Columbia regrets to announce the death at Vancouver on 26th December 1938 of James D. Small, C.A., Vice-President of the Institute, at the age of fifty-two.

The late Mr. Small was born in Montreal, Quebec, was a graduate of McGill University, but had lived in Vancouver for twenty-five years, having served his articles with members of this Institute. He had been a member of this Institute since 1916 and had served on the Council for some time. He had practised his profession under the firm name of James D. Small & Company.

Mr. Small will be greatly missed by all the members and his loss is deeply regretted. The sincere sympathy of all the members is extended to Mrs. Small.

STOCK BROKERS' ACCOUNTS

Theory and Practice

This series of discussions on the subject of stock brokerage accounting theory and practice has been prepared by a group of members of the profession familiar with the subject. They desire to have it understood that the definitions, opinions and observations appearing in this column are their own and are not necessarily those of the Dominion Association.

(Continued from January issue)

Some Stock Market Terms

Market Order—A "Market Order" is an order given to the broker by the customer to buy or sell securities at the market price and means that the trade is to be executed at the prevailing price.

These orders are executed by the broker in the order in which they are received by him.

Market orders are good only for the day on which they are given, unless they are given as Open Market orders.

A Limit Order—A "Limit Order" is an order given by the customer to the broker to buy or sell, but a price limit is set over which the broker cannot go on a purchase, or below which he cannot sell. It is good for a day unless placed with the broker as an Open Limit order, which is good until cancelled.

A Stop Loss Order—A "Stop Loss Order" is an order given by the customer to the broker to buy or sell, as the case may be, a certain security, when the price named in the order is realized in the market quotations for that particular security.

The object of placing such an order by the customer is to limit his loss to the difference between the price at which the security was bought or sold short, and the price as specified in the Stop Loss order.

In a rapidly changing market, it does not necessarily follow that the broker will be able to execute the order at the stated price. As soon as the given price is reached or passed, the order becomes a Market order and ranks with other Market orders.

Contingent Liabilities

The following contingent liabilities are more or less usual to stock brokers' accounts:—

1. Where the liabilities in a foreign currency exceed the assets in that currency, the cost of purchasing the addi-

tional funds necessary to meet the liabilities may increase due to a rise in the rate of exchange.

2. Any outstanding drafts drawn on customers or brokers would be a contingent liability, the bank having given credit to the broker when the drafts were deposited. If securities were attached to the draft, the contingent liability would only be the excess of the face value of the draft over the market value of such securities.

3. Some time after the delivery of a stock certificate by a broker, the person receiving it may discover that it bears a forged endorsement or is unacceptable for some other reason. If it is not possible to have this adjusted with the person from whom he received the certificate, the broker may suffer a loss.

4. Accounts disputed by clients due to errors made in executing or failing to execute orders.

A Hazard of Short Sales

"Short Selling" in the security markets has been left to the professional trader and those of the public familiar with the mechanics of the "short sale." The reason for this is probably twofold—a lack of a comprehensive knowledge of the purpose of a "short sale" and a wholesome respect for its inherent dangers.

One phase of this danger can be readily perceived when an actual problem is presented. Assume that a party "A" has concluded that a certain security, selling at \$.75 is about to fall in price, and that he should take what is known as a short position in this stock. He sells 1,000 shares at \$.75 and the broker's records show him owing 1,000 shares of this security and the broker owing him, "A", \$750.00. "A" will have to deposit with the broker the usual margin requirements. Subsequent to this transaction the market may rise and "A" has the privilege of instructing his broker either to buy the security in at an advanced price and bear the loss, or put up more margin.

It is not an uncommon situation for securities in this price range to double and treble in the course of a few days. It is even conceivable that in the course of a few days this security might become very closely held and "A" be forced to pay an exorbitant price to cover his short position.

Anyone taking a short position in stocks in any price

range has available certain standard practices as a protection against these dangers. However, if these safeguards are not used, it is possible to see how, under specific circumstances, the loss on a short sale might be excessive.

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding, too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(Continued from January issue)

(Note: Please note the following *errata* in this Department for January: ". . . various holders" in the definition of "Negotiable Instruments" should read ". . . previous holders." "New Current Assets" in the fifth line from the bottom of page 68 should read "Net Current Assets.")

O

Objects and Powers: A company or corporation being an artificial person created by law it is necessary that its particular objects and powers be definitely stated and this is done in the charter or other instrument of incorporation. Under the various joint stock companies acts of the Dominion and Provinces, all incorporated companies have conferred on them certain general (auxiliary) powers. It is necessary, in auditing, to see, as far as can be judged, that there has been no contravention of the objects and powers of a company; this is particularly emphasized in those provinces where the auditor is required to make a specific statement in this regard.

Obligation: Pixley, in "The Accountants' Dictionary," gives the following as the correct legal meaning of the term: "An obligation or a bond is a deed whereby a person obliges himself, his heirs, executors, and administrators to pay a certain sum of money to another at a fixed date. The person who so obliges himself or enters into such a bond is called the obligor; the person to whom he so obliges or binds himself is called the obligee."

By common usage, however, the term is now used to represent any liability or duty enforceable by law.

Observed Depreciation: A term used by engineers or appraisers. It refers to the determination of depreciation by a physical inspection and appraisal, rather than by any calculation based on the estimated total life of the asset.

Obsolescence: The condition of becoming out of date, obsolete, useless, etc.; the diminution in the value of machinery and plant resulting from new discoveries and improvements, rendering previously acquired assets uneconomical for the purposes of competition; the diminution in the value of merchandise and materials resulting from changes in consumer demand or utility.

Officer (of a Company): One who holds in a corporation any office prescribed by a statute or by-law, such as president, vice-president, director, secretary and treasurer, and in some cases the auditor. The term is frequently applied to other employees having executive authority.

On Account: A description given to a partial payment as distinguished from one made in full settlement.

On Consignment: The term given to merchandise held by a consignee for sale and a subsequent accounting. See "Consignment."

Oncost: The British term for overhead as applied to manufacturing expenses; indirect costs; burden.

Open Account: Any account which still has a balance, i.e., has not been ruled off in settlement. It is not unusual to find in balance sheets an item of "Debtors on open accounts," and another "Debtors on notes or bills receivable." The difference is that open accounts may still be subject to dispute and adjustment; Bills or Notes usually are not so subject.

Opening Entries: (1) The first entries such as those to set up assets, liabilities, capital, etc. at the inception of a business.

(2) In the continent of Europe, where all accounts are closed out at the end of each accounting period, the first entries in the new year, made to re-open the books.

Operating: Having to do with the principal activities

of the business, as operating income, operating expense, operating profits, etc.; differentiated from extraneous matters such as interest on temporary investments (except in an investment company), extraordinary expenditures, etc.

Outgo: The antithesis of income; another word for expenditures (q.v.). Sometimes improperly used to describe disbursements.

Output: The quantity or value of goods manufactured during a stated period.

Outstanding: An adjective frequently used in connection with accounting terms, the shade of meaning of which varies slightly according to its uses; e.g., outstanding accounts, unpaid accounts; outstanding cheques, those issued but not yet presented at the bank; outstanding capital, issued capital less any redeemed (as in certain conditions with preference stock); outstanding liabilities, unpaid liabilities; outstanding orders, unfilled orders, etc.

Overdrawn: The state of any account when drawings have exceeded any available funds, as with bank accounts or appropriations. Hence "Overdraft."

Overhead: Expenses, burden, oncost; the cost of carrying on business over and above the direct costs of merchandise or manufactured goods.

P

Paper Profit: A profit anticipated but not realized; e.g., appreciation in market value of securities unsold.

Par: Equality. A term used to denote the face value of securities. Market prices are said to be at par when they are equal to the face values. See "Above Par," "Below Par," "Par of Exchange," and "Par Value."

Parent Company: A holding company (q.v.)

Par of Exchange: Equality of standard values and ratios between the currency of two different countries which maintain the same monetary standard.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

In the course of the series of interesting and provocative articles on "The Nature and Measurement of Income," which he contributed last summer to *The Accountant*, Mr. Ronald S. Edwards of the London School of Economics referred to an essay by Mr. F. A. von Hayek on "The Maintenance of Capital."¹ In this essay the author pointed out the diverse meanings that may be attached to the phrase 'maintenance of capital' and the failure of the trade cycle theorists to agree on the dimension of capital which they have in mind when they use the phrase. "Even more than this group," he goes on to say, "one should expect the writers on the income concept to have provided a clear answer. And even if the general discussions of the income concept should prove disappointing one should certainly feel entitled to expect a definite answer in the discussions of business profits, since profits of all things can evidently only be defined as the excess of the total business assets over the equivalent of the capital invested at the beginning of the period."

Where do the accountants stand in this matter? The answer is not clear but the impression which a reader would derive from a study of the text books of the profession is that accounting procedure (in its provision for depreciation) is intended to give that measure of income which will maintain intact the *money value* of the capital originally invested—provided the capitalist in making his original investment and all succeeding re-investments was in possession of perfect foresight. This proviso (though probably never actually satisfied) serves to explain the generally accepted plan of charging against gross income, to arrive at net income, depreciation on the investment at the rate which the capitalist believed to be appropriate at the time when he made the investment, and of treating as a loss of capital and not as a charge against periodic income the cost of any failure on the part of the capitalist to exercise perfect foresight.

¹*Economica*, (New Series) Vol. II, 1935, p. 241.

Mr. von Hayek however seems to think that the capitalist and the accountant aim at levelling off future periodic *money income* as from each point of time at which a change in the return from capital is revealed to them. This type of action he says "does not imply the maintenance of any dimension of capital as such, [but] means in other words that the capitalist treats his gross receipts during the transition period as a terminable annuity of which he wants to consume no more than such a constant amount, that the sinking fund accumulated at the end of the period will secure him the same income in perpetuity."

It would seem that those most directly concerned with the measurement of periodic income, viz. capitalists and accountants, have not yet decided what it is that they wish "income" to measure and that the formulation of some important principles of accounting must await a decision on this point.

* * *

Mr. Edwards, to whose articles reference was made above, does not hesitate to say what he thinks about accounting methods and accounting literature. He is particularly scathing in his references to the text book distinction between capital and revenue expenditure. Beginners are told that the distinction is fundamental and that failure or neglect to discriminate between the two will falsify the whole of the results of the bookkeeping. "But when we enquire how we should distinguish we are given definition by extension or we are told that capital expenditure results in the acquisition of assets."² It is to be feared that Mr. Edwards' strictures in this particular connection are fully deserved, for whilst the accountant undoubtedly has a consistent theory of the distinction and its use, those who have presumed to expound that theory have tended to get lost in a jungle of meaningless words and phrases like "lasting value," "incurred in the ordinary course of business," and so on.

Mr. Edwards' whole study would, we think, have been of greater value if the accounting texts on which he relies and which he appears to have studied so extensively and conscientiously had been more scientific in their rationalization of accounting practice.

²R. E. Edwards, *The Nature and Measurement of Income*, The Accountant, Vol. XCIX, p. 291.

STUDENTS' ASSOCIATION NOTES

SASKATCHEWAN—Saskatoon

The Saskatoon Chartered Accountant Students' Association held its annual dinner at The King George Hotel on 19th December last. A large gathering of students and chartered accountants was present.

Congratulations were extended by Mr. W. Stempel, C.A., on behalf of the Institute, to those who had passed the recent examinations.

Mr. V. J. Ferguson, F.C.A., was chairman for the evening and introduced Mr. Arthur Moxon, K.C., the guest speaker. Mr. Moxon gave a very interesting address on the interpretation of law, and cited recent English cases to show that distinction had been made, in certain judgments, between the "letter" of the law and the "intention" or "spirit" of the law. He pointed out that in Canada, instead of taking the matter to the courts for decision, it was becoming the practice, when such differences arose, to insert subsequently in the act in question a clause providing that an official of the government be empowered to determine what was the "intention" or "spirit" of that act. He felt this to be a detrimental practice in a democracy.

Mr. J. S. Owen, C.A., extended a hearty vote of thanks to the speaker.

* * *

PROBLEMS AND SOLUTIONS

The solution to the first problem given below was prepared by a practising member of the Manitoba Institute. The solution to the second problem was prepared by the Editor of The Students' Department who took the liberty of substituting dollar equivalents for the sterling figures of the original problem. The solutions represent the views and opinions of those who prepared them. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF MANITOBA

INTERMEDIATE EXAMINATIONS, MAY, 1938 BOOKKEEPING AND ACCOUNTS, SECTION II

Question No. I.

On 1st January, 1937, the partners of the firm of Allan, Birch and Carter decided they would forthwith discontinue business and

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wind up the partnership. A trustee was appointed on the same day to take over and dispose of the assets of the firm and to discharge its liabilities. After settlement of obligations to the public, the trustee was required to distribute between the partners, according to their respective rights and interests, the funds received by him from time to time.

The following is a statement of liabilities and capital of the partnership as they appeared on the books at 1st January, 1937.

Trade Creditors	\$15,000.00	
Partners' Capital Accounts—		
J. Allan	\$30,000.00	
A Birch	20,000.00	
	<u>\$50,000.00</u>	
Less C. Carter (deficit)	5,000.00	
		<u>45,000.00</u>
		<u><u>\$60,000.00</u></u>

An audit of the books performed during the month of January, 1937, revealed—

(a) That the following charges appertaining to the period of the partnership had not been recorded on the books:

Interest on temporary loan from J. Allan	\$ 500.00
Salary due A. Birch	5,000.00

(b) That certain machinery brought into the partnership by J. Allan had been recorded on the books at its original cost, viz: \$20,000.00, whereas its agreed value, according to the terms of the partnership agreement, was \$15,000.00.

(c) That goodwill contributed by A. Birch had been set up on the books at the value specified in the partnership agreement, viz: \$10,000.00; but in consequence of a subsequent agreement between the partners the asset had been written off the books and charged to Profit and Loss Account. In the subsequent sale of the partnership assets the business connection was disposed of for the sum of \$5,000.00.

At the time of the Trustee's appointment, C. Carter admitted being in financial difficulty and lacking funds required to settle his personal debts, but on 3rd May, 1937, as the result of an investigation made on his behalf, it was discovered that during the term of the partnership, certain remuneration amounting in all to \$15,000.00, to which he was entitled under the provisions of the partnership agreement, had not been recorded on the books of the firm.

Profits and losses are shared in the following proportions:

J. Allan	50%
A. Birch	30%
C. Carter	20%

The following sums, representing the entire proceeds from disposal of the partnership assets, out of which the trade creditors were paid a compromised settlement amounting to \$10,000.00 were distributed by the trustee on the dates mentioned:

4th April, 1937	\$27,000.00
19th June, 1937	28,500.00

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For his services the Trustee was permitted to retain, before final distribution, the sum of \$200.00.

J. Allan and A. Birch agreed that, for the purpose of allocating the possible loss to the partnership consequent upon C. Carter's apparent insolvency, the capital ratios as shown by the books at 1st January, 1937, be adopted.

Prepare a statement for submission by the Trustee showing his distribution of the partnership funds. Ignore the question of interest on capital.

(See solution on page 153)

COMMENTS

In working a problem of this type, the various transactions and adjustments must be recorded according to their natural sequence: consequently, in practically all cases, dates or periods of time are stated in the problem. However, the date on which the compromise arrangement with the creditors was effected is not given. Obviously this settlement took place on or before the date of payment to the creditors and, as the trustee would undoubtedly be required to discharge the firm's liabilities before disbursing moneys to the partners, the compromise is necessarily taken into account in arriving at the balances before the first distribution.

No reference is made to profit or loss on realization of assets at the time of the first distribution. Were the figure of profit or loss made known and the partners' accounts adjusted accordingly, the position at the date of the first distribution, as shown above, would not be altered.

No adjustment is required in respect of goodwill written off the books, for the reason that the cancellation of this item had been mutually agreed upon among the partners. However, even though the problem were to require reinstatement of this asset and adjustment of the loss on its disposal, the financial relationship between the partners would not be disturbed, nor would the division of the proceeds from the sale of the partnership assets be affected.

SOLUTION

Re Allan, Birch and Carter

Trustee's statement of distribution of partnership funds—January 1 to June 19, 1937

	Trade Creditors	J. Allan \$15,000.00	Partners' Capital Accounts J. Allan A. Birch C. Carter	Total
Balances according to the books as at January 1, 1937				
Adjustments of errors disclosed as the result of an audit performed during January, 1937:				
J. Allan—Interest on Loan				
A. Birch—Salary				
Reduction of book value of Machinery				
Reduction of liabilities by compromise				
Balances prior to first distribution	10,000.00	25,250.00	24,850.00	55,000.00
Deduct cash distribution—April 4, 1937:				
Trade Creditors	<u>10,000.00</u>			
Partners (for computation thereof see below)		4,830.00	12,170.00	27,000.00

Balances after first distribution	20,420.00	12,680.00	—5,100.00	28,000.00
Adjustment crediting C. Carter with remuneration, \$15,000.00				
Profit on Realization (Net)				
Cash distribution—June 19, 1937:				
\$28,500.00, less Trustee's fee \$200.00				
	\$13,070.00	\$ 8,270.00	\$ 6,960.00	\$28,300.00

Computation of first cash distribution (partners)

Balances prior to first distribution	\$25,250.00	\$24,850.00	\$—5,100.00
Deduct distribution of possible loss (to the extent of the unrealized assets—\$28,000.00)			
Adjusted balances	14,000.00	8,400.00	5,600.00
Division of C. Carter's deficit in the ratio of the solvent partners' balances of capital at January 1, 1937 according to the books			
Cash distribution	11,250.00	16,450.00	—10,700.00
	—6,420.00	—4,280.00	+10,700.00
	<u>\$ 4,830.00</u>	<u>\$12,170.00</u>	<u>—</u>

PROBLEM II
THE INSTITUTE OF CHARTERED ACCOUNTANTS IN
ENGLAND AND WALES

FINAL EXAMINATIONS, MAY, 1938

ADVANCED BOOKKEEPING AND ACCOUNTS
(Including Limited Companies)

Question No. 3

X Ltd. deliver their goods to customers in containers which they purchase for \$1.25 each, charge to customers at \$1.50 and credit to customers, if returned within six months at \$1.00 each. The containers are valued for stocktaking at \$.75 each.

On July 1, 1936, there were 2,000 containers in stock and 4,200 containers in the hands of customers for which the return period had not expired.

During the year ended June 30, 1937, 3,000 containers were purchased, 6,400 were sent out to customers, 4,600 were returned, 60 were accidentally destroyed in the warehouse and 100 were sold as scrap for \$25.00. In respect of 3,800 of the containers in the hands of customers on June 30, 1937, the return period had not expired.

Show the ledger entries which should be made on the company's books in respect of containers for the year ended June 30, 1937.

SOLUTION

(1) The opening balances on the ledger accounts at July 1, 1936, will be:

Containers Inventory Account	Dr. \$4,650.00	
(being 2,000 containers in the warehouse and 4,200 in the hands of customers, all priced at \$.75 each).		
Containers Shipped Account		Cr. \$4,200.00
(being the amount which will be credited to customers if they return within the time limit, containers at present in their hands).		

(2) The transactions for the year ended June 30, 1937 could be recorded by the following journal entries:

Containers Purchases	Dr. \$3,750.00	
To Accounts Payable		\$3,750.00
To record purchase of 3,000 containers at \$1.25 each.		
Accounts Receivable	Dr. 9,600.00	
To Containers Rental Charges		3,200.00
To Containers Shipped		6,400.00
To charge to customers 6,400 containers shipped at \$1.50 each, of which \$.50 represents rental charge and \$1.00 the "returnable" value.		
Containers Shipped	Dr. 4,600.00	
To Accounts Receivable		4,600.00
To record return of 4,600 containers by customers at "returnable" value of \$1.00 each.		

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Cash	Dr.	25.00	
To Container Sales			25.00
To record sale of 100 containers as scrap.			
Containers Shipped	Dr.	2,200.00	
To Containers Sales			2,200.00
To record expiration of return period for 2,200 containers in the hands of customers.			

(3) It will be noted that the Containers Shipped Account serves as a quantity control or perpetual inventory of the returnable containers in the hands of customers but that there is no such control of containers in the warehouse. It would probably be desirable therefore to operate a memorandum quantity control in the following form:

Containers in Warehouse (Quantities)

1936			1937		
July 1	Balance	2,000	June 30	Shipped to customers	6,400
1937				30 Destroyed	60
June 30	Purchases	3,000		30 Sold as scrap	100
30	Returned by customers	4,600		30 Balance in warehouse	3,040
		<u>9,600</u>			<u>9,600</u>

1937		
July 1	Balance	3,040

(4) The inventory of containers at June 30, 1937 is then computed as:

Containers in Warehouse	3,040
Containers in the hands of customers	3,800
Total	<u>6,840 at \$.75 = \$5,130</u>

and is journalized:

Containers Inventory Account	Dr. \$5,130.00	
To Containers Profit and Loss		\$5,130.00

(5) The ledger accounts appear as follows:

CONTAINERS INVENTORY

1936			1937		
July 1	Balance		June 30	Containers	
	6,200 at .75 ...	<u>\$4,650.00</u>		Profit and Loss	<u>\$4,650.00</u>

1937		
June 30	Containers	
	Profit and Loss—	
	6,840 at \$.75 ...	5,130.00

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CONTAINERS PURCHASES

1937		1937	
June 30	Accounts Payable	June 30	Containers Profit and Loss
	3,000 at \$1.25..		\$3,750.00
			<u>\$3,750.00</u>

CONTAINERS SHIPPED

1937		1936	
June 30	Accounts Receivable—	July 1	Balance
	4,600 at \$1.00..		4,200 at \$1.00..
	\$ 4,600.00		\$ 4,200.00
30	Container Sales—	1937	
	2,200 at \$1.00..	June 30	Accounts Receivable—
	2,200.00		6,400 at \$1.00..
30	Balance—		6,400.00
	3,800 at \$1.00..		
	3,800.00		
	<u>\$10,600.00</u>		<u>\$10,600.00</u>

1937	
July 1	Balance
	3,800.00

CONTAINERS RENTAL CHARGES

1937		1937	
June 30	Containers Profit and Loss	June 30	Accounts Receivable—
	Loss		6,400 at \$.50 ..
	\$3,200.00		<u>\$3,200.00</u>

CONTAINERS SALES

1937		1937	
June 30	Containers Profit and Loss	June 30	Cash—100 at
	Loss		\$.25
	\$2,225.00		\$ 25.00
		30	Containers Shipped—
			2,200 at \$1.00..
			2,200.00

CONTAINERS PROFIT AND LOSS

Inventory July 1, 1936..	\$4,650.00	Rentals	\$3,200.00
Purchases	3,750.00	Sales	2,225.00
	<u>8,400.00</u>		
Inventory, June 30, 1937	5,130.00		
	<u>3,270.00</u>		
Profit to Profit and Loss Account	2,155.00		
	<u>\$5,425.00</u>		<u>\$5,425.00</u>

(6) In the Balance Sheet the credit balance on Containers Shipped Account will be deducted from the Accounts Receivable in order to show the amount receivable in cash.

